LAKELAND BANCORP INC
Form 10-K
March 01, 2019
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549
FORM 10-K
(Mark One)
ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2018.
OR
TRANSITION REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE TRANSITION PERIOD FROM TO .
Commission file number: 000-17820

LAKELAND BANCORP, INC.
(Exact name of registrant as specified in its charter)

New Jersey (State or other jurisdiction of incorporation or organization)	22-2953275 (I.R.S. Employer Identification No.)

250 Oak Ridge Road, Oak Ridge, New Jersey 07438 (Address of principal executive offices) (Zip code)
Registrant's telephone number, including area code: (973) 697-2000
Securities registered pursuant to Section 12(b) of

the Act:

Title of each class	Name of each exchange on which registered
Common Stock, no par value	NASDAQ

Securities registered pursuant to
Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act:

Large accelerated filer		Accelerated filer	o
Non-accelerated filer	o	Smaller Reporting Company	o
Emerging growth company	o		

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by a check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of June 30, 2018, the aggregate market value of the registrant's common stock held by non-affiliates of the registrant was approximately $901,226,000, based on the closing sale price as reported on the NASDAQ Global Select Market.

The number of shares outstanding of the registrant's common stock, as of February 22, 2019, was 50,336,797.

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DOCUMENTS INCORPORATED BY REFERENCE:
Lakeland Bancorp, Inc's. Proxy Statement for its 2019 Annual Meeting of Shareholders (Part III).

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PART I

ITEM 1 - Business.

GENERAL

Lakeland Bancorp, Inc. (the “Company” or “Lakeland Bancorp”) is a bank holding company headquartered in Oak Ridge, New Jersey. The Company was organized in March of 1989 and commenced operations on May 19, 1989, upon the consummation of the acquisition of all of the outstanding stock of Lakeland Bank, formerly named Lakeland State Bank (“Lakeland” or the “Bank” or “Lakeland Bank”). The Bank operates 54 branch offices throughout Bergen, Essex, Morris, Ocean, Passaic, Somerset, Sussex, and Union counties in New Jersey and also including one branch in Highland Mills, New York; six New Jersey regional commercial lending centers in Bernardsville, Jackson, Montville, Newton, Teaneck and Waldwick; and one in New York to serve the Hudson Valley region. Lakeland also has a commercial loan production office serving Middlesex and Monmouth counties in New Jersey. Lakeland offers an extensive suite of financial products and services for businesses and consumers.

The Company has shown substantial growth through a combination of organic growth and acquisitions. Since 1998, the Company has acquired eight community banks with an aggregate asset total of approximately $2.3 billion, including its most recent acquisition of Highlands State Bank and its parent, Highlands Bancorp, Inc. ("Highlands Bancorp"), which closed on January 4, 2019. All of the acquired banks have been merged into Lakeland and the acquired holding companies, if applicable, have been merged into the Company.

At December 31, 2018, Lakeland Bancorp had total consolidated assets of $5.8 billion, total consolidated deposits of $4.6 billion, total consolidated loans, net of the allowance for loan and lease losses, of $4.4 billion and total consolidated stockholders’ equity of $623.7 million. Following the closing of Lakeland Bancorp's acquisition of Highlands Bancorp and its subsidiary, Highlands State Bank, on January 4, 2019, Lakeland Bancorp's total assets approximated $6.3 billion.

This Annual Report on Form 10-K contains certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 (“Forward-Looking Statements”). Such statements are subject to risks and uncertainties that could cause actual results to differ materially from those projected in such Forward-Looking Statements. Certain factors which could materially affect such results and the future performance of the Company are described in Item 1A - Risk Factors of this Annual Report on Form 10-K.

Unless otherwise indicated, all weighted average, actual shares and per share information contained in this Annual Report on Form 10-K have been adjusted retroactively for the effect of stock dividends, including the Company’s 5% stock dividend which was distributed on June 17, 2014.

Commercial Bank Services

Through Lakeland, the Company offers a broad range of lending, depository, and related financial services to individuals and small to medium sized businesses located primarily in northern and central New Jersey, the Hudson Valley region in New York, and surrounding areas. In the lending area, these services include commercial real estate loans, commercial and industrial loans, short and medium term loans, lines of credit, letters of credit, inventory and accounts receivable financing, real estate construction loans, mortgage loans, small business administration (“SBA”) loans and merchant credit card services. Through Lakeland’s equipment financing division, the Company provides a financing solution to small and medium sized companies who prefer to lease equipment over other financial alternatives. Lakeland’s asset based loan department provides commercial borrowers with another lending alternative. Depository products include demand deposits, as well as savings, money market and time accounts. Lakeland offers internet banking, mobile banking, wire transfer and night depository services to the business community and municipal relationships. In addition, Lakeland offers cash management services, such as remote capture of deposits and overnight sweep repurchase agreements.

Consumer Banking

Lakeland also offers a broad range of consumer banking services, including checking accounts, savings accounts, interest-bearing checking accounts, money market accounts, certificates of deposit, internet banking, secured and unsecured loans, consumer installment loans, mortgage loans, and safe deposit services.

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Other Services

Investment advisory services for individuals and businesses are also available. Additionally, through Lakeland Title Group LLC, the Bank provides commercial title insurance services and life insurance products through Lakeland Financial Services Agency, Inc.

Competition

Lakeland faces considerable competition in its market areas for deposits and loans from other depository institutions. Many of Lakeland's depository institution competitors have substantially greater resources, broader geographic markets, and higher lending limits than Lakeland and are also able to provide more services and make greater use of media advertising. In recent years, intense market demands, economic pressures, increased customer awareness of products and services, and the availability of electronic services have forced banking institutions to diversify their services and become more cost-effective.

Lakeland also competes with credit unions, brokerage firms, insurance companies, money market mutual funds, consumer finance companies, mortgage companies and other financial companies, some of which are not subject to the same degree of regulation and restrictions as Lakeland in attracting deposits and making loans. Interest rates on deposit accounts, convenience of facilities, products and services, and marketing are all significant factors in the competition for deposits. Competition for loans comes from other commercial banks, savings institutions, insurance companies, consumer finance companies, credit unions, mortgage banking firms and other institutional lenders. Lakeland primarily competes for loan originations through its structuring of loan transactions and the overall quality of service it provides. Competition is affected by the availability of lendable funds, general and local economic conditions, interest rates, and other factors that are not readily predictable.

The Company expects that competition will continue in the future.

Concentration

The Company is not dependent on deposits or exposed by loan concentrations to a single customer or a few customers, the loss of any one or more of which would have a material adverse effect upon the financial condition of the Company.

Employees

At December 31, 2018, the Company had 652 full-time equivalent employees. None of these employees are covered by a collective bargaining agreement. The Company considers relations with its employees to be good.

SUPERVISION AND REGULATION

General

The Company is a registered bank holding company under the Federal Bank Holding Company Act of 1956, as amended (the "Holding Company Act"), and is required to file with the Federal Reserve Board an annual report and such additional information as the Federal Reserve Board may require pursuant to the Holding Company Act. The Company has also elected financial holding company status under the Modernization Act, as further discussed below. The Company is subject to examination by the Federal Reserve Board.

Lakeland is a state chartered commercial bank subject to supervision and examination by the Department of Banking and Insurance of the State of New Jersey (the "Department") and the Federal Deposit Insurance Corporation (the "FDIC"). The regulations of the State of New Jersey and FDIC govern most aspects of Lakeland's business, including reserves against deposits, loans, investments, mergers and acquisitions, borrowings, dividends, and location of branch offices. Lakeland is subject to certain restrictions imposed by law on, among other things, (i) the maximum amount of obligations of any one person or entity which may be outstanding at any one time, (ii) investments in stock or other securities of the Company or any subsidiary of the Company, and (iii) the taking of such stock or securities as collateral for loans to any borrower.

The Holding Company Act

The Holding Company Act limits the activities which may be engaged in by the Company and its subsidiaries to those of banking, the ownership and acquisition of assets and securities of banking organizations, and the management of banking organizations, and to certain non-banking activities which the Federal Reserve Board finds, by order or regulation, to be so closely related to banking or managing or controlling a bank as to be a proper incident thereto. The

Federal Reserve Board is empowered to differentiate between activities by a bank holding company or a subsidiary thereof and activities commenced by acquisition of a going concern.

With respect to non-banking activities, the Federal Reserve Board has by regulation determined that several non-banking activities are closely related to banking within the meaning of the Holding Company Act and thus may be performed by bank holding companies. Although the Company's management periodically reviews other avenues of business opportunities that are included in that regulation, the Company has no present plans to engage in any of these activities other than providing investment brokerage services.

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With respect to the acquisition of banking organizations, the Company is required to obtain the prior approval of the Federal Reserve Board before it may, by merger, purchase or otherwise, directly or indirectly acquire all or substantially all of the assets of any bank or bank holding company, if, after such acquisition, it will own or control more than 5% of the voting shares of such bank or bank holding company.

Regulation of Bank Subsidiaries

There are various legal limitations, including Sections 23A and 23B of the Federal Reserve Act, which govern the extent to which a bank subsidiary may finance or otherwise supply funds to its holding company or its holding company's non-bank subsidiaries. Under federal law, no bank subsidiary may, subject to certain limited exceptions, make loans or extensions of credit to, or investments in the securities of, its parent or the non-bank subsidiaries of its parent (other than direct subsidiaries of such bank which are not financial subsidiaries) or take their securities as collateral for loans to any borrower. Each bank subsidiary is also subject to collateral security requirements for any loans or extensions of credit permitted by such exceptions.

Commitments to Affiliated Institutions

The policy of the Federal Reserve Board provides that a bank holding company is expected to act as a source of financial strength to its subsidiary banks and to commit resources to support such subsidiary banks in circumstances in which it might not do so absent such policy.

Interstate Banking

The Riegle-Neal Interstate Banking and Branching Efficiency Act of 1994 permits bank holding companies to acquire banks in states other than their home state, regardless of applicable state law. New Jersey enacted legislation to authorize interstate banking and branching and the entry into New Jersey of foreign country banks. New Jersey did not authorize de novo branching into the state. However, under federal law, federal savings banks, which meet certain conditions, may branch de novo into a state, regardless of state law. The Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") removes the restrictions on interstate branching contained in the Riegle-Neal Act, and allows national banks and state banks to establish branches in any state if, under the laws of the state in which the branch is to be located, a state bank chartered by that state would be permitted to establish the branch.

Gramm-Leach-Bliley Act of 1999

The Gramm-Leach-Bliley Financial Services Modernization Act of 1999 (the "Modernization Act") became effective in early 2000. The Modernization Act:

- allows bank holding companies meeting management, capital, and Community Reinvestment Act standards to engage in a substantially broader range of non-banking activities than previously was permissible, including insurance underwriting and making merchant banking investments in commercial and financial companies; if a bank holding company elects to become a financial holding company, it files a certification, effective in 30 days, and thereafter may engage in certain financial activities without further approvals (Lakeland Bancorp is such a financial holding company);
- allows insurers and other financial services companies to acquire banks;
- removes various restrictions that previously applied to bank holding company ownership of securities firms and mutual fund advisory companies; and
- establishes the overall regulatory structure applicable to bank holding companies that also engage in insurance and securities operations.

The Modernization Act also modified other financial laws, including laws related to financial privacy and community reinvestment.

The USA PATRIOT Act

As part of the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, Congress adopted the International Money Laundering Abatement and Financial Anti-Terrorism Act of 2001 (collectively, the "USA PATRIOT Act"). By way of amendments to the Bank Secrecy Act, Title III of the USA PATRIOT Act encourages information sharing among bank regulatory agencies and law enforcement bodies. Further, certain provisions of Title III impose affirmative obligations on a broad range of financial institutions, including banks, thrifts, brokers, dealers, credit unions, money transfer agents and parties registered under the Commodity Exchange Act.

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Among other requirements, Title III of the USA PATRIOT Act imposes the following requirements with respect to financial institutions:

- All financial institutions must establish anti-money laundering programs that include, at a minimum: (i) internal policies, procedures, and controls; (ii) specific designation of an anti-money laundering compliance officer; (iii) ongoing employee training programs; and (iv) an independent audit function to test the anti-money laundering program.
- The Secretary of the Department of the Treasury, in conjunction with other bank regulators, was authorized to issue regulations that provide for minimum standards with respect to customer identification at the time new accounts are opened.
- Financial institutions that establish, maintain, administer, or manage private banking accounts or correspondent accounts in the United States for non-United States persons or their representatives (including foreign individuals visiting the United States) are required to establish appropriate, specific and, where necessary, enhanced due diligence policies, procedures, and controls designed to detect and report money laundering.
- Financial institutions are prohibited from establishing, maintaining, administering or managing correspondent accounts for foreign shell banks (foreign banks that do not have a physical presence in any country), and will be subject to certain record keeping obligations with respect to correspondent accounts of foreign banks.
- Bank regulators are directed to consider a holding company's effectiveness in combating money laundering when ruling on Federal Reserve Act and Bank Merger Act applications.

The United States Treasury Department has issued a number of implementing regulations which address various requirements of the USA PATRIOT Act and are applicable to financial institutions such as Lakeland. These regulations impose obligations on financial institutions to maintain appropriate policies, procedures and controls to detect, prevent and report money laundering and terrorist financing and to verify the identity of their customers. Banking agencies have strictly enforced various anti-money laundering and suspicious activity reporting requirements using formal and informal enforcement tools to cause banks to comply with these provisions.

Sarbanes-Oxley Act of 2002

The Sarbanes-Oxley Act of 2002 (the "SOA") added new legal requirements for public companies affecting corporate governance, accounting and corporate reporting, to increase corporate responsibility and to protect investors.

The SOA addresses, among other matters:

- audit committees for all reporting companies;
- certification of financial statements by the chief executive officer and the chief financial officer;
- the forfeiture of bonuses or other incentive-based compensation and profits from the sale of an issuer's securities by directors and senior officers in the twelve month period following initial publication of any financial statements that later require restatement;
- a prohibition on insider trading during pension plan black out periods;
- disclosure of off-balance sheet transactions;
- a prohibition on personal loans to directors and officers (other than loans made by an insured depository institution (as defined in the Federal Deposit Insurance Act), if the loan is subject to the insider lending restrictions of Section 22(h) of the Federal Reserve Act);
- expedited filing requirements for Form 4's;
- disclosure of a code of ethics and filing a Form 8-K for a change or waiver of such code;
- "real time" filing of periodic reports;
- the formation of a public accounting oversight board;
- auditor independence; and
- various increased criminal penalties for violations of the securities laws.

The Securities and Exchange Commission (the "SEC") has enacted various rules to implement various provisions of the SOA with respect to, among other matters, disclosure in periodic filings pursuant to the Exchange Act. Each of the national stock exchanges, including the NASDAQ Stock Market where Lakeland Bancorp's common stock is listed, have corporate governance listing standards, including rules strengthening director independence requirements for boards, and requiring the adoption of charters for the nominating and corporate governance, compensation and audit committees.

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Regulation W

Transactions between a bank and its "affiliates" are quantitatively and qualitatively restricted under the Federal Reserve Act. The Federal Deposit Insurance Act applies Sections 23A and 23B to insured nonmember banks in the same manner and to the same extent as if they were members of the Federal Reserve System. The Federal Reserve Board has also issued Regulation W, which codifies prior regulations under Sections 23A and 23B of the Federal Reserve Act and interpretative guidance with respect to affiliate transactions. Regulation W incorporates the exemption from the affiliate transaction rules but expands the exemption to cover the purchase of any type of loan or extension of credit from an affiliate. Affiliates of a bank include, among other entities, the bank's holding company and companies that are under common control with the bank. The Company is considered to be an affiliate of Lakeland. In general, subject to certain specified exemptions, a bank or its subsidiaries are limited in their ability to engage in "covered transactions" with affiliates:

- to an amount equal to 10% of the bank's capital and surplus, in the case of covered transactions with any one affiliate; and
- to an amount equal to 20% of the bank's capital and surplus, in the case of covered transactions with all affiliates.

In addition, a bank and its subsidiaries may engage in covered transactions and other specified transactions only on terms and under circumstances that are substantially the same, or at least as favorable to the bank or its subsidiary, as those prevailing at the time for comparable transactions with nonaffiliated companies. A "covered transaction" includes:

- a loan or extension of credit to an affiliate;
- a purchase of, or an investment in, securities issued by an affiliate;
- a purchase of assets from an affiliate, with some exceptions;
- the acceptance of securities issued by an affiliate as collateral for a loan or extension of credit to any party; and
- the issuance of a guarantee, acceptance or letter of credit on behalf of an affiliate.

In addition, under Regulation W:

- a bank and its subsidiaries may not purchase a low-quality asset from an affiliate;
- covered transactions and other specified transactions between a bank or its subsidiaries and an affiliate must be on terms and conditions that are consistent with safe and sound banking practices; and
- with some exceptions, each loan or extension of credit by a bank to an affiliate must be secured by certain types of collateral with a market value ranging from 100% to 130%, depending on the type of collateral, of the amount of the loan or extension of credit.

Regulation W generally excludes all non-bank and non-savings association subsidiaries of banks from treatment as affiliates, except to the extent that the Federal Reserve Board decides to treat these subsidiaries as affiliates.

Community Reinvestment Act

Under the Community Reinvestment Act ("CRA"), as implemented by FDIC regulations, a state bank has a continuing and affirmative obligation consistent with its safe and sound operation to help meet the credit needs of its entire community, including low and moderate income neighborhoods. The CRA does not establish specific lending requirements or programs for financial institutions nor does it limit an institution's discretion to develop the types of products and services that it believes are best suited to its particular community. The CRA requires the FDIC, in connection with its examination of a state non-member bank, to assess the bank's record of meeting the credit needs of its community and to take that record into account in its evaluation of certain applications by the bank. Under the FDIC's CRA evaluation system, the FDIC focuses on three tests: (i) a lending test, to evaluate the institution's record of making loans in its service areas; (ii) an investment test, to evaluate the institution's record of investing in community development projects, affordable housing and programs benefiting low or moderate income individuals and businesses; and (iii) a service test, to evaluate the institution's delivery of services through its branches, ATMs and other offices. The CRA also requires all institutions to make public disclosure of their CRA ratings. Lakeland Bank received an "outstanding" CRA rating in its most recent examination.

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Securities and Exchange Commission

The common stock of the Company is registered with the SEC under the Exchange Act. As a result, the Company and its officers, directors, and major stockholders are obligated to file certain reports with the SEC. The Company is subject to proxy and tender offer rules promulgated pursuant to the Exchange Act. You may read and copy any document the Company files with the SEC at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information about the Public Reference Room. The SEC maintains a website at http://www.sec.gov that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC, such as the Company.

The Company maintains a website at http://www.lakelandbank.com. The Company makes available on its website the proxy statements and reports on Forms 8-K, 10-K and 10-Q that it files with the SEC as soon as reasonably practicable after such material is electronically filed with or furnished to the SEC. Additionally, the Company has adopted and posted on its website a Code of Ethics that applies to its principal executive officer, principal financial officer and principal accounting officer. The Company intends to disclose any amendments to or waivers of the Code of Ethics on its website.

Effect of Government Monetary Policies

The earnings of the Company are and will be affected by domestic economic conditions and the monetary and fiscal policies of the United States government and its agencies. The monetary policies of the Federal Reserve Board have had, and will likely continue to have, an important impact on the operating results of commercial banks through the Board's power to implement national monetary policy in order to, among other things, curb inflation or combat a recession. The Federal Reserve Board has a major effect upon the levels of bank loans, investments and deposits through its open market operations in United States government securities and through its regulation of, among other things, the discount rate of borrowings of banks and the reserve requirements against bank deposits. It is not possible to predict the nature and impact of future changes in monetary fiscal policies.

Dividend Restrictions

The Company is a legal entity separate and distinct from Lakeland. Virtually all of the revenue of the Company available for payment of dividends on its capital stock will result from amounts paid to the Company by Lakeland. All such dividends are subject to various limitations imposed by federal and state laws and by regulations and policies adopted by federal and state regulatory agencies. Under New Jersey state law, a bank may not pay dividends unless, following the dividend payment, the capital stock of the bank would be unimpaired and either (a) the bank will have a surplus of not less than 50% of its capital stock, or, if not, (b) the payment of the dividend will not reduce the surplus of the bank.

If, in the opinion of the FDIC, a bank under its jurisdiction is engaged in or is about to engage in an unsafe or unsound practice (which could include the payment of dividends), the FDIC may require, after notice and hearing, that such bank cease and desist from such practice or, as a result of an unrelated practice, require the bank to limit dividends in the future. The Federal Reserve Board has similar authority with respect to bank holding companies. In addition, the Federal Reserve Board and the FDIC have issued policy statements which provide that insured banks and bank holding companies should generally only pay dividends out of current operating earnings. Regulatory pressures to reclassify and charge off loans and to establish additional loan loss reserves can have the effect of reducing current operating earnings and thus impacting an institution's ability to pay dividends. Further, as described herein, the regulatory authorities have established guidelines with respect to the maintenance of appropriate levels of capital by a bank or bank holding company under their jurisdiction. Compliance with the standards set forth in these policy statements and guidelines could limit the amount of dividends which the Company and Lakeland may pay. Banking institutions that fail to maintain the minimum capital ratios, or that maintain the requisite minimum capital ratios but do so at a level below the minimum capital ratios plus the new capital conservation buffer, will face constraints on their ability to pay dividends. See "Capital Requirements" below.

Capital Requirements

Pursuant to the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), each federal banking agency has promulgated regulations, specifying the levels at which a financial institution would be considered "well capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized," or "critically undercapitalized," and to take certain mandatory and discretionary supervisory actions based on the capital level of the institution. To qualify to engage in financial activities under the Gramm-Leach-Bliley Act, all depository institutions must be "well capitalized." The financial holding company of a bank will be put under directives to raise its capital levels or divest its activities if the depository institution falls from that level.

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In July 2013, the Federal Reserve Board, the FDIC and the Comptroller of the Currency adopted final rules establishing a new comprehensive capital framework for U.S. banking organizations (the "Basel Rules"). The Basel Rules implement the Basel Committee's December 2010 framework, commonly referred to as Basel III, for strengthening international capital standards as well as certain provisions of the Dodd-Frank Act, as discussed below. The Basel Rules substantially revise the risk-based capital requirements applicable to bank holding companies and depository institutions, including Lakeland Bancorp and Lakeland Bank, compared to prior U.S. risk-based capital rules. The Basel Rules define the components of capital and address other issues affecting the numerator in banking institutions' regulatory capital ratios. The Basel Rules also address risk weights and other issues affecting the denominator in banking institutions' regulatory capital ratios and replace the existing risk-weighting approach, which was derived from Basel I capital accords of the Basel Committee, with a more risk-sensitive approach based, in part, on the standardized approach in the Basel Committee's 2004 Basel II capital accords. The Basel Rules also implement the requirements of Section 939A of the Dodd-Frank Act to remove references to credit ratings from the federal banking agencies' rules.

The Basel Rules became effective for us on January 1, 2015 (subject to phase-in periods for certain components). For bank holding companies and banks like Lakeland Bancorp and Lakeland Bank, January 1, 2015 was the start date for compliance with the revised minimum regulatory capital ratios and for determining risk-weighted assets under what the Basel Rules call a "standardized approach." As of January 1, 2015, Lakeland Bancorp and Lakeland Bank were required to maintain the following minimum capital ratios, expressed as a percentage of risk-weighted assets:

- Common Equity Tier 1 Capital Ratio of 4.5% (this is referred to as the "CET1");
- Tier 1 Capital Ratio (CET1 capital plus "Additional Tier 1 capital") of 6.0%; and
- Total Capital Ratio (Tier 1 capital plus Tier 2 capital) of 8.0%.

In addition, Lakeland Bancorp and Lakeland Bank are subject to a leverage ratio of 4.0% (calculated as Tier 1 capital to average consolidated assets as reported on the consolidated financial statements).

The Basel Rules also require a "capital conservation buffer." As of the full phase-in on January 1, 2019, Lakeland Bancorp and Lakeland Bank are required to maintain a 2.5% capital conservation buffer, in addition to the minimum capital ratios described above, effectively resulting in the following minimum capital ratios on January 1, 2019:

- CET1 of 7.0%;
- Tier 1 Capital Ratio of 8.5%; and
- Total Capital Ratio of 10.5%.

The purpose of the capital conservation buffer is to ensure that banking organizations conserve capital when it is needed most, allowing them to weather periods of economic stress. Banking institutions with a CET1, Tier 1 Capital Ratio and Total Capital Ratio above the minimum capital ratios but below the minimum capital ratios plus the capital conservation buffer will face constraints on their ability to pay dividends, repurchase equity and pay discretionary bonuses to executive officers, based on the amount of the shortfall. The implementation of the capital conservation buffer began on January 1, 2016 at the 0.625% level, and increased by 0.625% on each subsequent January 1 until it reached 2.5% on January 1, 2019. Accordingly, as of January 1, 2019, the minimum capital ratios applicable to Lakeland Bancorp and Lakeland Bank are 7.0% for CET1, 8.5% for Tier 1 Capital and 10.5% for Total Capital.

The Basel Rules also adopted a "countercyclical capital buffer," which is not applicable to Lakeland Bancorp or Lakeland Bank. That buffer is applicable only to "advanced approaches banking organizations," which generally are those with consolidated total assets of at least $250 billion.

The Basel Rules provide for several deductions from and adjustments to CET1, which were phased in as of January 1, 2018. For example, mortgage servicing rights, deferred tax assets dependent upon future taxable income and significant investments in common equity issued by nonconsolidated financial entities must be deducted from CET1 to the extent that any one of those categories exceeds 10% of CET1 or all such categories in the aggregate exceed 15% of CET1.

Under prior capital standards, the effects of accumulated other comprehensive income items included in capital were excluded for the purposes of determining regulatory capital ratios. Under the Basel Rules, the effects of certain accumulated other comprehensive income items are not excluded; however, banking organizations such as Lakeland

Bancorp and Lakeland Bank were permitted to make a one-time permanent election to continue to exclude these items effective as of January 1, 2015. Lakeland Bancorp and Lakeland Bank made such an election to continue to exclude these items.

While the Basel Rules generally require the phase-out of non-qualifying capital instruments such as trust preferred securities and cumulative perpetual preferred stock, holding companies with less than $15 billion in total consolidated assets as of December 31, 2009, such as Lakeland Bancorp, may permanently include non-qualifying instruments that were issued and included in Tier 1 or Tier 2 capital prior to May 19, 2010 in Additional Tier 1 or Tier 2 capital until they redeem such instruments or until the instruments mature.

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The Basel Rules prescribe a standardized approach for calculating risk-weighted assets that expands the risk-weighting categories from the previous four categories (0%, 20%, 50% and 100%) to a much larger and more risk-sensitive number of categories, depending on the nature of the assets, generally ranging from 0% for U.S. Government and agency securities, to 600% for certain equity exposures, and resulting in higher risk weights for a variety of asset categories. In addition, the Basel Rules provide more advantageous risk weights for derivatives and repurchase-style transactions cleared through a qualifying central counterparty and increase the scope of eligible guarantors and eligible collateral for purposes of credit risk mitigation.

Consistent with the Dodd-Frank Act, the Basel Rules adopt alternatives to credit ratings for calculating the risk-weighting for certain assets.

With respect to Lakeland Bank, the Basel Rules revise the "prompt corrective action" regulations under Section 38 of the Federal Deposit Insurance Act by (i) introducing a CET1 ratio requirement at each capital quality level (other than critically undercapitalized), with the required CET1 ratio being 6.5% for well-capitalized status (a new standard); (ii) increasing the minimum Tier 1 capital ratio requirement for each category, with the minimum Tier 1 capital ratio for well-capitalized status being 8% (increased from 6%); and (iii) requiring a leverage ratio of 5% to be well-capitalized (increased from the previously required leverage ratio of 3% or 4%). The Basel Rules do not change the total risk-based capital requirement for any "prompt corrective action" category.

Effective as of January 1, 2015, the FDIC's regulations implementing these provisions of FDICIA provide that an institution will be classified as "well capitalized" if it (i) has a total risk-based capital ratio of at least 10.0 percent, (ii) has a Tier 1 risk-based capital ratio of at least 8.0 percent, (iii) has a CET1 ratio of at least 6.5 percent, (iv) has a Tier 1 leverage ratio of at least 5.0 percent, and (v) meets certain other requirements. An institution will be classified as "adequately capitalized" if it (i) has a total risk-based capital ratio of at least 8.0 percent, (ii) has a Tier 1 risk-based capital ratio of at least 6.0 percent, (iii) has a CET1 ratio of at least 4.5 percent, (iv) has a Tier 1 leverage ratio of at least 4.0 percent, and (v) does not meet the definition of "well capitalized." An institution will be classified as "undercapitalized" if it (i) has a total risk-based capital ratio of less than 8.0 percent, (ii) has a Tier 1 risk-based capital ratio of less than 6.0 percent, (iii) has a CET1 ratio of less than 4.5 percent or (iv) has a Tier 1 leverage ratio of less than 4.0 percent. An institution will be classified as "significantly undercapitalized" if it (i) has a total risk-based capital ratio of less than 6.0 percent, (ii) has a Tier 1 risk-based capital ratio of less than 4.0 percent, (iii) has a CET1 ratio of less than 3.0 percent or (iv) has a Tier 1 leverage ratio of less than 3.0 percent. An institution will be classified as "critically undercapitalized" if it has a tangible equity to total assets ratio that is equal to or less than 2.0 percent. An insured depository institution may be deemed to be in a lower capitalization category if it receives an unsatisfactory examination rating. Similar categories apply to bank holding companies. When the capital conservation buffer is fully phased in, the capital ratios applicable to depository institutions under the Basel Rules will exceed the ratios to be considered well-capitalized under the prompt corrective action regulations.

As of December 31, 2018, Lakeland Bancorp and Lakeland Bank met all capital requirements under the Basel Rules as then in effect, and the Company believes that as of such date, it would meet all capital requirements under the Basel Rules on a fully phased-in basis, if the full phase-in of such requirements were currently in effect.

Volcker Rule

In December 2013, the Federal Reserve Board, the FDIC and several other governmental regulatory agencies issued final rules to implement the Volcker Rule contained in section 619 of the Dodd-Frank Act, generally to become effective on July 21, 2015. The Federal Reserve extended the Volcker Rule's conformance period until July 21, 2017. In August 2017, the U.S. Comptroller of the Currency, one of the federal bank regulators, announced he was soliciting public comment on how the Volcker Rule should be revised to better accomplish its purposes. The Volcker Rule prohibits an insured depository institution and its affiliates from (i) engaging in "proprietary trading" and (ii) investing in or sponsoring certain types of funds (defined as "Covered Funds") subject to certain limited exceptions. The Company does not own any interests in any hedge funds or private equity funds that are designated "Covered Funds" under the Volcker Rule.

Federal Deposit Insurance and Premiums

Lakeland's deposits are insured up to applicable limits by the Deposit Insurance Fund ("DIF") of the FDIC and are subject to deposit insurance assessments to maintain the DIF. As a result of the Dodd-Frank Act, the basic federal deposit insurance limit was permanently increased to at least $250,000.

In November 2010, the FDIC approved a rule to change the assessment base from adjusted domestic deposits to average consolidated total assets minus average tangible equity, as required by the Dodd-Frank Act. Since the new base is larger than the current base, the FDIC's rule lowered the total base assessment rates to between 2.5 and 9 basis points for banks in the lowest risk category, and 30 to 45 basis points for banks in the highest risk category. The Company paid $1.6 million in total FDIC assessments in 2018 and $1.6 million in 2017.

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Pursuant to the Dodd-Frank Act, the FDIC has established 2.0% as the designated reserve ratio (“DRR”), that is, the ratio of the DIF to insured deposits. The FDIC has adopted a plan under which it will meet the statutory minimum DRR of 1.35% by September 30, 2020, the deadline imposed by the Dodd-Frank Act. The Dodd-Frank Act requires the FDIC to offset the effect on institutions with assets less than $10 billion of the increase in the statutory minimum DRR to 1.35% from the former statutory minimum of 1.15%. In March 2016, the FDIC adopted a rule that imposes a surcharge on the quarterly assessments of insured depository institutions with total consolidated assets of $10 billion or more. The surcharge equals an annual rate of 4.5 basis points applied to the institution’s assessment base, with certain adjustments.

In addition to deposit insurance assessments, the FDIC is required to continue to collect from institutions payments for the servicing of obligations of the Financing Corporation (“FICO”) that were issued in connection with the resolution of savings and loan associations, so long as such obligations remain outstanding. Lakeland paid a FICO premium of approximately $149,000 in 2018. The last of the remaining FICO bonds will mature in September 2019 and the FDIC anticipates that the last FICO assessment will be collected on March 29, 2019 with a provision that, should additional funds be required, another assessment will be collected in June 2019. Lakeland anticipates its FICO premium to be approximately $20,000 in 2019.

The Dodd-Frank Act

The Dodd-Frank Act, which was signed into law on July 21, 2010, significantly changed the bank regulatory landscape and has impacted and will continue to have a broad impact on the financial services industry as a result of significant regulatory and compliance changes, including, among other things, (i) enhanced resolution authority over troubled and failing banks and their holding companies; (ii) increased capital and liquidity requirements; (iii) increased regulatory examination fees; (iv) changes to assessments to be paid to the FDIC for federal deposit insurance; and (v) numerous other provisions designed to improve supervision and oversight of, and strengthening safety and soundness for, the financial services sector. Generally, the Dodd-Frank Act became effective the day after it was signed into law, but different effective dates apply to specific sections of the law.

The following is a summary of certain provisions of the Dodd-Frank Act:

- Minimum Capital Requirements. The Dodd-Frank Act requires new capital rules and the application of the same leverage and risk-based capital requirements that apply to insured depository institutions to most bank holding companies. In addition to making bank holding companies subject to the same capital requirements as their bank subsidiaries, these provisions (often referred to as the Collins Amendment to the Dodd-Frank Act) were also intended to eliminate or significantly reduce the use of hybrid capital instruments, especially trust preferred securities, as regulatory capital. See “Capital Requirements.”
- Deposit Insurance. The Dodd-Frank Act makes permanent the $250,000 deposit insurance limit for insured deposits. Amendments to the Federal Deposit Insurance Act also revised the assessment base against which an insured depository institution’s deposit insurance premiums paid to the Deposit Insurance Fund (“DIF”) are calculated. See “Federal Deposit Insurance and Premiums.”
- Shareholder Votes. The Dodd-Frank Act requires publicly traded companies like Lakeland Bancorp to give shareholders a non-binding vote on executive compensation and so-called “golden parachute” payments in certain circumstances.
- Transactions with Affiliates. The Dodd-Frank Act enhances the requirements for certain transactions with affiliates under Section 23A and 23B of the Federal Reserve Act, including an expansion of the definition of “covered transactions” and increasing the amount of time for which collateral requirements regarding covered transactions must be maintained.
- Transactions with Insiders. Insider transaction limitations are expanded through the strengthening of loan restrictions to insiders and the expansion of the types of transactions subject to the various limits, including derivative transactions, repurchase agreements, reverse repurchase agreements and securities lending or borrowing transactions. Restrictions are also placed on certain asset sales to and from an insider to an institution, including requirements that such sales be on market terms and, in certain circumstances, approved by the institution’s board of directors.
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Enhanced Lending Limits. The Dodd-Frank Act strengthened the previous limits on a depository institution's credit exposure to one borrower which limited a depository institution's ability to extend credit to one person (or group of related persons) in an amount exceeding certain thresholds. The Dodd-Frank Act expanded the scope of these restrictions to include credit exposure arising from derivative transactions, repurchase agreements, and securities lending and borrowing transactions.

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- Compensation Practices. The Dodd-Frank Act provides that the appropriate federal regulators must establish standards prohibiting as an unsafe and unsound practice any compensation plan of a bank holding company or other "covered financial institution" that provides an insider or other employee with "excessive compensation" or compensation that gives rise to excessive risk or could lead to a material financial loss to such firm. In June 2010, prior to the Dodd-Frank Act, the bank regulatory agencies promulgated the Interagency Guidance on Sound Incentive Compensation Policies, which sets forth three key principles concerning incentive compensation arrangements: such arrangements should provide employees incentives that balance risk and financial results in a manner that does not encourage employees to expose the financial institution to imprudent risks; such arrangements should be compatible with effective controls and risk management; and such arrangements should be supported by strong corporate governance with effective and active oversight by the financial institution's board of directors.

Together, the Dodd-Frank Act and guidance from the bank regulatory agencies on compensation may impact the Company's compensation practices.

- The Consumer Financial Protection Bureau ("Bureau"). The Dodd-Frank Act created the Bureau within the Federal Reserve. The Bureau is tasked with establishing and implementing rules and regulations under certain federal consumer protection laws with respect to the conduct of providers of certain consumer financial products and services. The Bureau has rulemaking authority over many of the statutes governing products and services offered to bank consumers. In addition, the Dodd-Frank Act permits states to adopt consumer protection laws and regulations that are more stringent than those regulations promulgated by the Bureau and state attorneys general are permitted to enforce consumer protection rules adopted by the Bureau against state-chartered institutions. The Bureau has examination and enforcement authority over all banks and savings institutions with more than $10 billion in assets. Institutions with $10 billion or less in assets, such as the Bank, will continue to be examined for compliance with the consumer laws by their primary bank regulators.
- De Novo Banking. The Dodd-Frank Act allows de novo interstate branching by banks.

Final rules have been issued which implement the ability-to-repay and qualified mortgage (QM) provisions of the Truth in Lending Act, as amended by the Dodd-Frank Act (the "QM Rule"). The QM Rule impacted our mortgage originations when it became effective in January 2014. The ability-to-repay provision requires creditors to make reasonable, good faith determinations that borrowers are able to repay their mortgages before extending the credit based on a number of factors and consideration of financial information about the borrower from reasonably reliable third-party documents. Under the Dodd-Frank Act and the QM Rule, loans meeting the definition of "qualified mortgage" are entitled to a presumption that the lender satisfied the ability-to-repay requirements. The presumption is a conclusive presumption/safe harbor for prime loans meeting the QM requirements, and a rebuttable presumption for higher-priced/subprime loans meeting the QM requirements. The definition of a "qualified mortgage" incorporates the statutory requirements, such as not allowing negative amortization or terms longer than 30 years. The QM Rule also adds an explicit maximum 43 percent debt-to-income ratio for borrowers if the loan is to meet the QM definition, though some mortgages that meet GSE, FHA and VA underwriting and eligibility guidelines may, for a period not to exceed seven years, meet the QM definition without being subject to the 43 percent debt-to-income limits. We cannot assure you that existing or future regulations will not have a material adverse impact on our residential mortgage loan business or the housing markets in which we participate.

In addition, provisions in the Dodd-Frank Act which have revised the capital requirements of the Company and the Bank could require the Company and the Bank to seek additional sources of capital in the future. See "Capital Requirements."

The Dodd-Frank Act contains numerous other provisions affecting financial institutions of all types, many of which may have an impact on our operating environment in substantial and unpredictable ways. Consequently, the Dodd-Frank Act is likely to continue to increase our cost of doing business, it may limit or expand our permissible activities, and it may affect the competitive balance within our industry and market areas.

Proposed Legislation

From time to time proposals are made in the United States Congress, the New Jersey Legislature, and before various bank regulatory authorities, which would alter the powers of, and place restrictions on, different types of banking organizations. It is impossible to predict the impact, if any, of potential legislative trends on the business of the Company and its subsidiaries.

In accordance with federal law providing for deregulation of interest on all deposits, banks and thrift organizations are now unrestricted by law or regulation from paying interest at any rate on most time deposits. It is not clear whether deregulation and other pending changes in certain aspects of the banking industry will result in further increases in the cost of funds in relation to prevailing lending rates.

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ITEM 1A - Risk Factors.

Our business, financial condition, operating results and cash flows can be affected by a number of factors, including, but not limited to, those set forth below, any one of which could cause our actual results to vary materially from recent results or from our anticipated future results.

Credit Risks

Our allowance for loan and lease losses may not be adequate to cover actual losses.

Like all commercial banks, Lakeland Bank maintains an allowance for loan and lease losses to provide for loan and lease defaults and non-performance. If our allowance for loan and lease losses is not adequate to cover actual loan and lease losses, we may be required to significantly increase future provisions for loan and lease losses, which could materially and adversely affect our operating results. Our allowance for loan and lease losses is determined by analyzing historical loan and lease losses, current trends in delinquencies and charge-offs, plans for problem loan and lease resolution, the opinions of our regulators, changes in the size and composition of the loan and lease portfolio and industry information. We also consider the possible effects of economic events, which are difficult to predict. The amount of future losses is affected by changes in economic, operating and other conditions, including changes in interest rates, many of which are beyond our control. These losses may exceed our current estimates. Federal regulatory agencies, as an integral part of their examination process, review our loans and the allowance for loan and lease losses. While we believe that our allowance for loan and lease losses in relation to our current loan portfolio is adequate to cover current losses, we cannot assure you that we will not need to increase our allowance for loan and lease losses or that the regulators will not require us to increase this allowance. Future increases in our allowance for loan and lease losses could materially and adversely affect our earnings and profitability.

A change in accounting standards could also cause an increase in Lakeland's allowance for loan and lease losses. In June 2016, the FASB issued an accounting standards update pertaining to the measurement of credit losses on financial instruments. This update requires the measurement of all expected credit losses for financial instruments held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions, such as Lakeland, and other organizations will now use forward-looking information to better inform their credit loss estimates. This update will be effective for fiscal years and interim periods beginning after December 15, 2019. While Lakeland is currently evaluating the impact that this standard could have on its financial statements, the adoption of this update is likely to cause an increase in Lakeland's allowance for loan and lease losses and a reduction in capital.

The concentration of our commercial real estate loan portfolio may subject us to increased regulatory analysis, or otherwise adversely affect our business and operating results.

The FDIC, the Federal Reserve and the OCC have promulgated joint guidance on sound risk management practices for financial institutions with concentrations in commercial real estate (CRE) lending. The 2006 interagency guidance did not establish specific CRE lending limits or caps; rather, the guidance set forth supervisory criteria to serve as levels of bank CRE concentration above which certain financial institutions may be identified for further supervisory analysis. According to the guidelines, institutions could be subject to further analysis if (i) their loans for construction, land, and land development (CLD) represent 100% or more of the institution's total risk-based capital, or (ii) their total non-owner-occupied CRE loans (including CLD loans), as defined, represent 300% or more of the institution's total risk-based capital, and further, that the institution's non-owner-occupied CRE loan portfolio has increased by 50% or more during the previous 36 months.

The Bank's total reported CLD loans represented 53% of total risk-based capital at December 31, 2018. The Bank's total reported CRE loans to total capital was 425% at December 31, 2018, while the Bank's CRE portfolio has increased by 104% over the preceding 36 months. The growth rate of the preceding 36 months included the acquisitions of Pascack Community Bank and Harmony Bank, but did not include the acquisition of Highlands State Bank.

The Bank's CRE portfolio is segmented and spread among various property types including retail, office, multi-family, mixed use, industrial, hospitality, healthcare, special use and residential and commercial construction. Management regularly reviews and evaluates its CRE portfolio, including concentrations within the various property types based on current market conditions and risk appetite as well as by utilizing stress testing on material exposures and believes its underwriting practices are sound.

There is no assurance that in the future we will not continue to exceed the levels set forth in the guidelines. Furthermore, the concentration of our commercial real estate portfolio could materially and adversely affect our business and operating results, including our overall profitability, and/or adversely impact the growth of our business, including the growth and composition of our overall loan portfolio.

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Our mortgage banking operations expose us to risks that are different than the risks associated with our retail banking operations.

The Bank’s mortgage banking operations expose us to risks that are different than our retail banking operations. Our mortgage banking operations are dependent upon the level of demand for residential mortgages. During higher and rising interest rate environments, the level of refinancing activity tends to decline, which can lead to reduced volumes of business and lower revenues that may not exceed our fixed costs to run the business. In addition, mortgages sold to third-party investors are typically subject to certain repurchase provisions related to borrower refinancing, defaults, fraud or other reasons stipulated in the applicable third-party investor agreements. If the fair value of a loan when repurchased is less than the fair value when sold, a bank may be required to charge such shortfall to earnings.

In addition, the “ability to repay” and “Qualified Mortgage” rules promulgated as required by the Dodd-Frank Act, may expose the Company to greater losses, reduced volume and litigation related expenses and delays in taking title to collateral real estate, if these loans do not perform and borrowers challenge whether the rules were satisfied when originating the loans.

We are subject to various lending and other economic risks that could adversely affect our results of operations and financial condition.

Economic, political and market conditions, trends in industry and finance, legislative and regulatory changes, changes in governmental monetary and fiscal policies and inflation affect our business. These factors are beyond our control. A deterioration in economic conditions, particularly in the markets we lend in, could have the following consequences, any of which could materially adversely affect our business:

- loan and lease delinquencies may increase;
- problem assets and foreclosures may increase;
- demand for our products and services may decrease; and
- collateral for loans made by us may decline in value, in turn reducing the borrowing ability of our customers.

Deterioration in the real estate market, particularly in New Jersey, could adversely affect our business. A decline in real estate values in New Jersey would reduce our ability to recover on defaulted loans by selling the underlying real estate, which would increase the possibility that we may suffer losses on defaulted loans.

We may suffer losses in our loan portfolio despite our underwriting practices.

We seek to mitigate the risks inherent in our loan portfolio by adhering to specific underwriting practices. Although we believe that our underwriting criteria are appropriate for the various kinds of loans that we make, we may incur losses on loans that meet our underwriting criteria, and these losses may exceed the amounts set aside as reserves in our allowance for loan and lease losses.

Liquidity and Interest Rate Risks

A decrease in our ability to borrow funds could adversely affect our liquidity.

Our ability to obtain funding from the Federal Home Loan Bank ("FHLB") or through our overnight federal funds lines with other banks could be negatively affected if we experienced a substantial deterioration in our financial condition or if such funding became restricted due to deterioration in the financial markets. While we have a contingency funds management plan to address such a situation if it were to occur (such plan includes deposit promotions, the sale of securities and the curtailment of loan growth, if necessary), a significant decrease in our ability to borrow funds could adversely affect our liquidity.

Public funds deposits are an important source of funds for us and a reduced level of those deposits may hurt our profits.

Public funds deposits are a significant source of funds for our lending and investment activities. The Company’s public funds deposits consist of deposits from local government entities, domiciled in the state of New Jersey, such as school districts, counties and other municipalities, and are collateralized by letters of credit from the FHLB and investment securities. Given our use of these high-average balance public funds deposits as a source of funds, our inability to retain such funds could adversely affect our liquidity. In addition, Governor Phil Murphy of New Jersey has proposed the creation of a state-owned bank which would accept public revenues to be invested in New Jersey. A bill was introduced in the New Jersey legislature in January 2018 that calls for the establishment of such a state-run bank.

While no assurance can be provided that such a bank will be created, to the extent that a state-run bank is established and accepts public revenues, the amount of the Company's public funds deposits could be reduced, which could adversely affect our liquidity.

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Further, our public funds deposits are primarily demand deposit accounts or short-term time deposits and are therefore more sensitive to interest rate risks. If we are forced to pay higher rates on our public funds accounts to retain those funds, or if we are unable to retain such funds and we are forced to resort to other sources of funds for our lending and investment activities, such as borrowings from the FHLB, the interest expense associated with these other funding sources may be higher than the rates we are currently paying on our public funds deposits, which would adversely affect our net income.

We are subject to interest rate risk and variations in interest rates that may negatively affect our financial performance.

We are unable to predict actual fluctuations of market interest rates. Rate fluctuations are influenced by many factors, including:

- inflation or deflation
- excess growth or recession;
- a rise or fall in unemployment;
- tightening or expansion of the money supply;
- domestic and international disorder;
- instability in domestic and foreign financial markets; and
- actions taken or statements made by the Federal Reserve Board.

Both increases and decreases in the interest rate environment may reduce our profits. We expect that we will continue to realize income from the difference or "spread" between the interest we earn on loans, securities and other interest-earning assets, and the interest we pay on deposits, borrowings and other interest-bearing liabilities. Our net interest spreads are affected by the differences between the maturities and repricing characteristics of our interest-earning assets and interest-bearing liabilities. Our interest-earning assets may not reprice as slowly or rapidly as our interest-bearing liabilities. Changes in market interest rates could materially and adversely affect our net interest spread, asset quality, levels of prepayments, cash flows, market value of our securities portfolio, loan and deposit growth, costs and yields on loans and deposits and our overall profitability. Competition for our deposits has increased significantly as a result of the rising interest rate environment.

Declines in value may adversely impact our investment portfolio.

As of December 31, 2018, the Company had approximately $638.6 million and $153.6 million in available for sale and held to maturity investment securities, respectively. We may be required to record impairment charges on our investment securities if they suffer a decline in value that is considered other-than-temporary. Numerous factors, including lack of liquidity for sales of certain investment securities, absence of reliable pricing information for investment securities, adverse changes in business climate, adverse actions by regulators, or unanticipated changes in the competitive environment could have a negative effect on our investment portfolio in future periods. If an impairment charge is significant enough it could affect the ability of Lakeland to upstream dividends to the Company, which could have a material adverse effect on our liquidity and our ability to pay dividends to shareholders and could also negatively impact our regulatory capital ratios.

Information Technology or Cybersecurity Risks

The occurrence of any failure, breach, or interruption in service involving our systems or those of our service providers could damage our reputation, cause losses, increase our expenses, and result in a loss of customers, an increase in regulatory scrutiny, or expose us to civil litigation and possibly financial liability, any of which could adversely impact our financial condition, results of operations and the market price of our stock.

In the ordinary course of business, we rely on electronic communications and information systems to conduct our operations and to store sensitive data. Any failure, interruption or breach in security of these systems could result in significant disruption to our operations. Information security breaches and cybersecurity-related incidents may include, but are not limited to, attempts to access information, including customer and company information, malicious code, computer viruses and denial of service attacks that could result in unauthorized access, misuse, loss or destruction of data (including confidential customer information), account takeovers, unavailability of service or other events. These types of threats may derive from human error, fraud or malice on the part of external or internal parties, or may result from accidental technological failure. Further, to access our products and services our customers may use computers and mobile devices that are beyond our security control systems. Our technologies, systems, networks and software, and those of other financial institutions have been, and are likely to continue to be, the target of cybersecurity threats and attacks, which may range from uncoordinated individual attempts to sophisticated and targeted measures directed at us. The risk of a security breach or disruption, particularly through cyber attack or cyber intrusion, has increased as the number, intensity and sophistication of attempted attacks and intrusions from around the world have increased.

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Our business requires the collection and retention of large volumes of customer data, including personally identifiable information in various information systems that we maintain and in those maintained by third parties with whom we contract to provide data services. We also maintain important internal company data such as personally identifiable information about our employees and information relating to our operations. The integrity and protection of that customer and company data is important to us. Our collection of such customer and company data is subject to extensive regulation and oversight.

Our customers and employees have been, and will continue to be, targeted by parties using fraudulent e-mails and other communications in attempts to misappropriate passwords, bank account information or other personal information or to introduce viruses or other malware through “Trojan horse” programs to our information systems and/or our customers' computers. Though we endeavor to mitigate these threats through product improvements, use of encryption and authentication technology and customer and employee education, such cyber attacks against us or our merchants and our third party service providers remain a serious issue. The pervasiveness of cybersecurity incidents in general and the risks of cyber crime are complex and continue to evolve. More generally, publicized information concerning security and cyber-related problems could inhibit the use or growth of electronic or web-based applications or solutions as a means of conducting commercial transactions.

Although we make significant efforts to maintain the security and integrity of our information systems and have implemented various measures to manage the risk of a security breach or disruption, there can be no assurance that our security efforts and measures will be effective or that attempted security breaches or disruptions would not be successful or damaging. Even the most well protected information, networks, systems and facilities remain potentially vulnerable because attempted security breaches, particularly cyber attacks and intrusions, or disruptions will occur in the future, and because the techniques used in such attempts are constantly evolving and generally are not recognized until launched against a target, and in some cases are designed not to be detected and, in fact, may not be detected. Accordingly, we may be unable to anticipate these techniques or to implement adequate security barriers or other preventative measures, and thus it is virtually impossible for us to entirely mitigate this risk. While we maintain specific “cyber” insurance coverage, which would apply in the event of various breach scenarios, the amount of coverage may not be adequate in any particular case. Furthermore, because cyber threat scenarios are inherently difficult to predict and can take many forms, some breaches may not be covered under our cyber insurance coverage.

A security breach or other significant disruption of our information systems or those related to our customers, merchants and our third party vendors, including as a result of cyber attacks, could (i) disrupt the proper functioning of our networks and systems and therefore our operations and/or those of certain of our customers; (ii) result in the unauthorized access to, and destruction, loss, theft, misappropriation or release of confidential, sensitive or otherwise valuable information of ours or our customers; (iii) result in a violation of applicable privacy, data breach and other laws, subjecting us to additional regulatory scrutiny and expose us to civil litigation, governmental fines and possible financial liability; (iv) require significant management attention and resources to remedy the damages that result; or (v) harm our reputation or cause a decrease in the number of customers that choose to do business with us. The occurrence of any of the foregoing could have a material adverse effect on our business, financial condition and results of operations.

The inability to stay current with technological change could adversely affect our business model.

Financial institutions continually are required to maintain and upgrade technology in order to provide the most current products and services to their customers, as well as create operational efficiencies. This technology requires personnel resources, as well as significant costs to implement. Failure to successfully implement technological change could adversely affect the Company’s business, results of operations and financial condition.

Our operations rely on certain third party vendors.

We rely on certain external vendors to provide products and services necessary to maintain our day-to-day operations. These third party vendors are sources of operational and informational security risk to us, including risks associated with operational errors, information system interruptions or breaches and unauthorized disclosures of sensitive or confidential client or customer information. If these vendors encounter any of these issues, or if we have difficulty communicating with them, we could be exposed to disruption of operations, loss of service or connectivity to customers, reputational damage, and litigation risk that could have a material adverse effect on our business and, in turn, our financial condition and results of operations.

In addition, our operations are exposed to risk that these vendors will not perform in accordance with the contracted arrangements under service level agreements. While we have selected these external vendors carefully, we do not control their actions. The failure of an external vendor to perform in accordance with the contracted arrangements under service level agreements, because of changes in the vendor's organizational structure, financial condition, support for existing products and services or strategic focus or for any other reason, could be disruptive to our operations, which could have a material adverse effect on our business and, in turn, our financial condition and results of operations. Replacing these external vendors could also entail significant delay and expense.

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Legal and Regulatory Risks

The Dodd-Frank Act could materially and adversely affect us by increasing compliance costs, heightening our risk of noncompliance with applicable regulations, and changing the competitive landscape in the banking industry.

The Dodd-Frank Act has resulted in sweeping changes in the regulation of financial institutions. As discussed in the section herein entitled "Business-Supervision and Regulation," the Dodd-Frank Act contains numerous provisions that affect all banks and bank holding companies. Some of the provisions in the Dodd-Frank Act were subject to regulatory rule-making and implementation, the full effects of which are not yet fully known. Although we cannot predict the full and specific impact and long-term effects that the Dodd-Frank Act and the regulations promulgated thereunder will have on us and our prospects, our target markets and the financial industry more generally, we believe that the Dodd-Frank Act and the regulations promulgated thereunder are likely to continue to impose additional administrative and regulatory burdens that will obligate us to continue to incur additional expenses and will continue to adversely affect our margins and profitability. For example, the elimination of the prohibition on the payment of interest on demand deposits could materially increase our interest expense, depending on our competitors' responses. Provisions in the legislation mandating modification of the capital requirements applicable to the Company and the Bank, and the resulting adoption by federal regulators of the new capital requirements described under "Business-Supervision and Regulation-Capital Requirements," could require the Company and the Bank to seek additional sources of capital in the future. More stringent consumer protection regulations could materially and adversely affect our profitability.

President Donald Trump has stated that he intends to relax financial regulations, including various provisions of the Dodd-Frank Act and the rules implementing those provisions. The nature and extent of future legislative and regulatory changes affecting financial institutions remains very unpredictable at this time.

The Company and the Bank are subject to more stringent capital and liquidity requirements.

The Dodd-Frank Act also imposes more stringent capital requirements on bank holding companies such as Lakeland Bancorp by, among other things, imposing leverage ratios on bank holding companies and prohibiting new trust preferred issuances from counting as Tier I capital. These restrictions will limit our future capital strategies. Under the Dodd-Frank Act, our currently outstanding trust preferred securities will continue to count as Tier I capital, but we will be unable to issue replacement or additional trust preferred securities which would count as Tier I capital.

As further described above under "Business-Supervision and Regulation-Capital Requirements," we were required to meet new capital requirements beginning on January 1, 2015. In addition, beginning in 2016, banks and bank holding companies were required to maintain a capital conservation buffer on top of minimum risk-weighted asset ratios. The implementation of the capital conservation buffer began on January 1, 2016 at the 0.625% level, and increased by 0.625% on each subsequent January 1 until it reached 2.5% when fully phased in on January 1, 2019. Banking institutions which do not maintain capital in excess of the capital conservation buffer face constraints on the payment of dividends, equity repurchases and compensation based on the amount of the shortfall. Accordingly, if the Bank fails to maintain the applicable minimum capital ratios and the capital conservation buffer, distributions to Lakeland Bancorp may be prohibited or limited.

Future increases in minimum capital requirements could adversely affect our net income. Furthermore, our failure to comply with the minimum capital requirements could result in our regulators taking formal or informal actions against us which could restrict our future growth or operations.

The extensive regulation and supervision to which we are subject impose substantial restrictions on our business.

The Company, Lakeland and certain non-bank subsidiaries are subject to extensive regulation and supervision. Banking regulations are primarily intended to protect depositors' funds, federal deposit insurance funds and the banking system as a whole. Such laws are not designed to protect our shareholders. These regulations affect our lending practices, capital structure, investment practices, dividend policy and growth, among other things. Lakeland is also subject to a number of laws which, among other things, govern its lending practices and require the Bank to establish and maintain comprehensive programs relating to anti-money laundering and customer identification. The United States Congress and federal regulatory agencies continually review banking laws, regulations and policies for possible changes. Changes to statutes, regulations or regulatory policies, including changes in interpretation or implementation of statutes, regulations or policies, could affect us in substantial and unpredictable ways. Such changes could subject us to additional costs, limit the types of financial services and products we may offer and/or increase the ability of non-banks to offer competing financial services and products, among other things. Failure to comply with laws, regulations or policies could result in sanctions by regulatory agencies, civil money penalties and/or reputational damage, which could have a material adverse effect on our business, financial condition and results of operations.

Lakeland's ability to pay dividends is subject to regulatory limitations which, to the extent that our holding company requires such dividends in the future, may affect our holding company's ability to pay its obligations and pay dividends to shareholders.

As a bank holding company, the Company is a separate legal entity from Lakeland Bank and its subsidiaries, and we do not have significant operations of our own. We currently depend on Lakeland Bank's cash and liquidity to pay our operating expenses and dividends to shareholders. The availability of dividends from Lakeland Bank is limited by various statutes and regulations. The inability of the Company to receive dividends from Lakeland Bank could adversely affect our financial condition, results of operations, cash flows and prospects and the Company's ability to pay dividends.

In addition, as described under "Business-Supervision and Regulation-Capital Requirements," banks and bank holding companies are required to maintain a capital conservation buffer on top of minimum risk-weighted asset ratios. The implementation of the capital conservation buffer began on January 1, 2016 at the 0.625% level, and increased by 0.625% on each subsequent January 1 until it reached 2.5% when fully phased in on January 1, 2019. Banking institutions which do not maintain capital in excess of the capital conservation buffer will face constraints on the payment of dividends, equity repurchases and compensation based on the amount of the shortfall. Accordingly, if Lakeland Bank fails to maintain the applicable minimum capital ratios and the capital conservation buffer, distributions to Lakeland Bancorp may be prohibited or limited.

Strategic and External Risks

The effect of the Tax Cuts and Jobs Act and future tax reform is uncertain and may adversely affect our business.

The current Presidential administration and U.S. Congress passed significant reform of the Internal Revenue Code, known as the Tax Cuts and Jobs Act of 2017 ("the Tax Act"). We have completed the process of determining the accounting under ASC Topic 740, Income Taxes, for the income tax effects of the Tax Cuts and Jobs Act, as discussed in the related notes to the consolidated financial statements. The Company has therefore disclosed the impact that the Tax Act will have on its financial position and the results of operations. Technical corrections or other forthcoming guidance could change how we interpret provisions of the Tax Act, which may impact our effective tax rate and could affect our deferred tax assets, tax positions and/or our tax liabilities.

While the decline in the federal corporate tax rate from 35% to 21% will lower the Company's income tax expense as a percent of its taxable income in 2018, other provisions of the Tax Act or future tax reform could negatively impact certain balance sheet and tax positions taken by the Company. The Tax Act imposes higher limitations on the deductibility of interest and property tax expenses which may adversely impact the property values of real estate used to secure loans and create an additional tax burden for many borrowers, particularly in high tax jurisdictions such as the State of New Jersey where the Company operates. These and other federal tax changes could significantly impact the financial health of our customers, potentially resulting, in among other things, an inability to repay loans or maintain deposits at the Bank. Any negative financial impact to our customers resulting from tax reform could adversely impact our financial condition and earnings.

The ultimate impact of any tax reform on our business, customers and shareholders is uncertain and could be adverse.

Recent New Jersey legislative changes may increase tax expense.

In connection with adopting the 2019 fiscal year budget, the New Jersey legislature adopted, and the Governor signed, legislation that will increase our state income tax liability and could increase our overall tax expense. The legislation imposes a temporary surtax of 2.5% on corporations earning New Jersey allocated income in excess of $1.0 million for tax years beginning on or after January 1, 2018 through December 31, 2019, and of 1.5% for tax years beginning on or after January 1, 2020 through December 31, 2021. The legislation also requires combined filing for members of a combined group for tax years beginning on or after January 1, 2019, and limits the deductibility of dividends received. These changes are not temporary. Regulations implementing the legislative changes have not yet been issued, and we cannot yet fully evaluate the impact of the legislation on overall tax expense or the valuation of the deferred tax asset. It is likely that we will lose the benefit of various tax management strategies, and as a result, the total tax expense will increase. We have completed the initial process of determining the accounting under ASC Topic 740, Income Taxes, for the income tax effects of the recent New Jersey legislation, as discussed in the related notes to the consolidated financial statements. Technical corrections or other forthcoming guidance could change how we interpret provisions of the New Jersey Tax legislation, which may impact our effective tax rate and could affect our deferred tax assets, tax positions and/or tax liabilities.

Severe weather, acts of terrorism and other external events could impact our ability to conduct business.

Weather-related events have adversely impacted our market area in recent years, especially areas located near coastal waters and flood prone areas. Such events that may cause significant flooding and other storm-related damage may become more common events in the future. Financial institutions have been, and continue to be, targets of terrorist threats aimed at compromising operating and communication systems and the metropolitan New York area, including New Jersey, remain central targets for potential acts of terrorism. Such events could cause significant damage, impact the stability of our facilities and result in additional expenses, impair the ability of our borrowers to repay their loans, reduce the value of collateral securing repayment of our loans,

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and result in the loss of revenue. While we have established and regularly test disaster recovery procedures, the occurrence of any such event could have a material adverse effect on our business, operations and financial condition.

We face intense competition from other financial services and financial services technology companies, and competitive pressures could adversely affect our business or financial performance.

The Company faces intense competition in all of its markets and geographic regions. The Company expects competitive pressures to intensify in the future, especially in light of legislative and regulatory initiatives arising out of the recent global economic crisis, technological innovations that alter the barriers to entry, current economic and market conditions, and government monetary and fiscal policies. Competition with financial services technology companies, or technology companies partnering with financial services companies, may be particularly intense, due to, among other things, differing regulatory environments. Competitive pressures may drive the Company to take actions that the Company might otherwise eschew, such as lowering the interest rates or fees on loans or raising the interest rates on deposits in order to keep or attract high-quality customers. These pressures also may accelerate actions that the Company might otherwise elect to defer, such as substantial investments in technology or infrastructure. Whatever the reason, actions that the Company takes in response to competition may adversely affect its results of operations and financial condition. These consequences could be exacerbated if the Company is not successful in introducing new products and other services, achieving market acceptance of its products and other services, developing and maintaining a strong customer base, or prudently managing expenses.

The Company’s future growth may require the Company to raise additional capital in the future, but that capital may not be available when it is needed or may be available only at an excessive cost.

The Company is required by regulatory authorities to maintain adequate levels of capital to support its operations. The Company anticipates that current capital levels will satisfy regulatory requirements for the foreseeable future. The Company, however, may at some point choose to raise additional capital to support its continued growth. The Company’s ability to raise additional capital will depend, in part, on conditions in the capital markets at that time, which are outside of the Company’s control. Accordingly, the Company may be unable to raise additional capital, if and when needed, on terms acceptable to the Company, or at all. If the Company cannot raise additional capital when needed, its ability to further expand operations through internal growth and acquisitions could be materially impacted. In the event of a material decrease in the Company’s stock price, future issuances of equity securities could result in dilution of existing shareholder interests.

Operational Risks

The Company may incur impairment to goodwill.

We review our goodwill at least annually. Our valuation methodology for assessing impairment requires management to make judgments and assumptions based on historical experience and to rely on projections of future operating performance. We operate in a competitive environment and projections of future operating results and cash flows may vary significantly from actual results. Additionally, if our analysis results in an impairment to our goodwill, we would be required to record a non-cash charge to earnings in our financial statements during the period in which such impairment is determined to exist. Any such charge could have a material adverse effect on our results of operations and our stock price.

We could be adversely affected by failure in our internal controls.

We continue to devote a significant amount of effort, time and resources to continually strengthen our controls and ensure compliance with complex accounting standards and banking regulations. A failure in our internal controls could have a significant negative impact not only on our earnings, but also on the perception that customers, regulators and investors may have of us.

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Our risk management strategies may not be fully effective in mitigating our risk exposures in all market environments or against all types of risk.

We have devoted significant resources to develop our risk management policies and procedures and expect to continue to do so in the future. Nonetheless, our risk management strategies may not be fully effective in mitigating our risk exposure in all market environments or against all types of risk, including risks that are unidentified or unanticipated. As our products and services change and grow and the markets in which we operate evolve, our risk management strategies may not always adapt to those changes. Some of our methods of managing risk are based upon our use of observed historical market behavior and management's judgment. As a result, these methods may not predict future risk exposures, which could be significantly greater than the historical measures indicate. Management of market, credit, liquidity, operational, legal, regulatory and compliance risks requires, among other things, policies and procedures to record properly and verify a large number of transactions and events and these policies and procedures may not be fully effective. While we employ a broad and diversified set of risk monitoring and risk mitigation techniques, those techniques and the judgments that accompany their application cannot anticipate every economic and financial outcome or the timing of such outcomes. Any of these circumstances could have an adverse effect on our business, financial condition and results of operations.

The inability to attract and retain key personnel could adversely affect our Company's business.

The success of the Company depends partially on the ability to attract and retain a high level of experienced personnel. The inability to attract and retain key employees, as well as find suitable replacements, if necessary, could adversely affect the Company's customer relationships and internal operations.

The accuracy of our financial statements and related disclosures could be affected if the judgments, assumptions or estimates used in our critical accounting policies are inaccurate.

The preparation of financial statements and related disclosure in conformity with GAAP requires us to make judgments, assumptions and estimates that affect the amounts reported in our consolidated financial statements and accompanying notes. Our critical accounting policies, which are included in Item 7 of this report captioned "Management's Discussion and Analysis of Financial Condition and Results of Operations", describe those significant accounting policies and methods used in the preparation of our consolidated financial statements that we consider "critical" because they require judgments, assumptions and estimates that materially affect our consolidated financial statements and related disclosures. As a result, if future events differ significantly from the judgments, assumptions and estimates in our critical accounting policies, those events or assumptions could have a material impact on our consolidated financial statements and related disclosures.

If we do not successfully integrate any banks that we may acquire in the future, the combined company may be adversely affected.

If we make acquisitions in the future, we will need to integrate the acquired entities into our existing business and systems. We may experience difficulties in accomplishing this integration or in effectively managing the combined company after any future acquisition. Any actual cost savings or revenue enhancements that we may anticipate from a future acquisition will depend on future expense levels and operating results, the timing of certain events and general industry, regulatory and business conditions. Many of these events will be beyond our control, and we cannot assure you that if we make any acquisitions in the future, we will be successful in integrating those businesses into our own.

ITEM 1B - Unresolved Staff Comments.

Not Applicable.

ITEM 2 – Properties.

Lakeland Bank conducts business through 54 branch offices located throughout Bergen, Essex, Morris, Ocean, Passaic, Somerset, Sussex, and Union counties in New Jersey and also including one branch in Highland Mills, New York. Lakeland Bank also operates six New Jersey regional commercial lending centers in Bernardsville, Jackson, Montville, Newton, Teaneck and Waldwick; and one in New York to serve the Hudson Valley region. Lakeland also has a commercial loan production office serving Middlesex and Monmouth counties in New Jersey. The Company's principal office is located at 250 Oak Ridge Road, Oak Ridge, New Jersey 07438.

The aggregate net book value of premises and equipment was $49.2 million at December 31, 2018. As of December 31, 2018, 26 of the Company’s facilities were owned and 33 were leased for various terms.

ITEM 3 - Legal Proceedings.

There are no pending legal proceedings involving the Company or Lakeland other than those arising in the normal course of business. Management does not anticipate that the potential liability, if any, arising out of such legal proceedings will have a material effect on the financial condition or results of operations of the Company and Lakeland on a consolidated basis.

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ITEM 3A - Executive Officers of the Registrant.

The following table sets forth the name and age of each current executive officer of the Company. Each officer is appointed by the Company's Board of Directors. Unless otherwise indicated, the persons named below have held the position indicated for more than the past five years.

Name and Age	Officer of the Company Since	Position with the Company, its Subsidiary Banks, and Business Experience
Thomas J. Shara Age 61	2008	President and CEO of the Company and the Bank (April 2008 - Present); President and Chief Credit Officer (May 2007 - April 2008) and Executive Vice President and Senior Commercial Banking Officer (February 2006 - May 2007), TD Banknorth, N.A.'s Mid-Atlantic Division.
Thomas F. Splaine, Jr. Age 53	2016	Executive Vice President and Chief Financial Officer of the Company and the Bank (March 2017 - Present); First Senior Vice President and Chief Accounting Officer of the Company and the Bank (May 2016 - March 2017); Senior Vice President, Financial Planning and Analysis and Investor Relations of Investors Bancorp, Inc. (January 2015 - December 2015); Senior Vice President and Chief Financial Officer of Investors Bancorp, Inc. (2008 - 2015).
Ronald E. Schwarz Age 64	2009	Senior Executive Vice President and Chief Operating Officer of the Company and the Bank (January 2017 - Present); Senior Executive Vice President and Chief Revenue Officer of the Company and the Bank (January 2016 - January 2017); Executive Vice President and Chief Retail Officer of the Company and the Bank (June 2009 - December 2015); Executive Vice President and Market Executive of Sovereign Bank (June 2006 - June 2009).
Ellen Lalwani Age 55	2018	Executive Vice President and Chief Retail Officer of the Company and the Bank (January 2018 - Present); Senior Vice President and Director of Retail Sales of the Bank (August 2008 - January 2018).
Timothy J. Matteson, Esq. Age 49	2008	Executive Vice President, Chief Administrative Officer, General Counsel and Corporate Secretary of the Company (January 2017 - Present); Executive Vice President, General Counsel and Corporate Secretary of the Company (March 2012 - January 2017); Senior Vice President and General Counsel of the Company (September 2008 - March 2012); Assistant General Counsel, Israel Discount Bank (November 2007 - September 2008); Senior Attorney and Senior Vice President, TD Banknorth, N.A. (February 2006 - May 2007); General Counsel and Senior Vice President, Hudson United Bancorp and Hudson United Bank (January 2005 - February 2006).
James M. Nigro Age 51	2016	Executive Vice President, Chief Risk Officer of the Company (March 2016 - Present); Senior Vice President, Credit Risk Manager of The Provident Bank (December 2013 - March 2016); Senior Vice-President, Commercial Lending of Lakeland Bank (May 2013 - December 2013); Executive Vice President, Chief Lending Officer of Somerset Hills Bank (July 2001 - May 2013).
John F. Rath, III Age 60	2018	Executive Vice President and Chief Lending Officer of the Company and the Bank (January 2018 - Present); First Senior Vice-President, Lending

Group Manager of the Company (January 2016 - January 2018); Senior Vice-President, Commercial Lending of the Company (March 2015-January 2016); Senior Vice-President, Lending Group Manager of TD Bank (August 1998 - March 2015).

ITEM 4 - Mine Safety Disclosures.
Not applicable.

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PART II

Item 5 - Market for the Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Shares of the common stock of Lakeland Bancorp, Inc. have been traded under the symbol “LBAI” on the NASDAQ Global Select Market (or the NASDAQ National Market) since February 22, 2000 and in the over the counter market prior to that date. As of December 31, 2018, there were approximately 2,895 shareholders of record of the common stock. The following table sets forth the range of the high and low daily closing prices of the common stock as provided by NASDAQ and dividends declared for the periods presented.

	High	Low	Dividends Declared
Year Ended December 31, 2018			
First Quarter	$21.05	$19.10	$ 0.100
Second Quarter	20.95	19.30	0.115
Third Quarter	20.70	18.05	0.115
Fourth Quarter	18.08	13.88	0.115

	High	Low	Dividends Declared
Year Ended December 31, 2017			
First Quarter	$20.75	$18.00	$ 0.095
Second Quarter	20.35	18.40	0.100
Third Quarter	20.40	17.65	0.100
Fourth Quarter	21.65	19.05	0.100

Dividends on the Company’s common stock are within the discretion of the Board of Directors of the Company and are dependent upon various factors, including the future earnings and financial condition of the Company and Lakeland and bank regulatory policies.

The Bank Holding Company Act of 1956 restricts the amount of dividends the Company can pay. Accordingly, dividends should generally only be paid out of current earnings, as defined.

The New Jersey Banking Act of 1948 restricts the amount of dividends paid on the capital stock of New Jersey chartered banks. Accordingly, no dividends shall be paid by such banks on their capital stock unless, following the payment of such dividends, the capital stock of the bank will be unimpaired and the bank will have a surplus of not less than 50% of its capital stock, or, if not, the payment of such dividend will not reduce the surplus of the bank. Under this limitation, approximately $544.1 million was available for the payment of dividends from Lakeland Bank to the Company as of December 31, 2018.

Capital guidelines and other regulatory requirements may further limit the Company’s and Lakeland’s ability to pay dividends. See “Item 1 - Business - Supervision and Regulation - Dividend Restrictions” and “Capital Requirements.”

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The following chart compares the Company's cumulative total shareholder return (on a dividend reinvested basis) over the past five years commencing December 31, 2013 and ending December 31, 2018 with the NASDAQ Market Index and the Peer Group Index. The Peer Group Index is the Zacks Regional Northeast Banks Index, which consists of 95 Regional Northeast Banks.

COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN
Assumes Initial Investment of $100
December 2018

Company/Market/Peer Group	12/31/2013	12/31/2014	12/31/2015	12/31/2016	12/31/2017	12/31/2018
Lakeland Bancorp, Inc.	100.00	102.30	106.28	181.74	183.10	144.25
NASDAQ Market Index	100.00	114.75	122.74	133.62	173.22	168.30
Regional Northeast Banks	100.00	108.04	113.01	157.09	164.47	143.56

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Item 6 - Selected Financial Data.

SELECTED CONSOLIDATED FINANCIAL DATA

The following should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and the Company's consolidated financial statements included in Items 7 and 8 of this report. The selective financial data set forth below has been derived from the Company's audited consolidated financial statements.

	At or for the Years Ended December 31,				
	2018	2017	2016	2015	2014
	(in thousands, except per share data)				
Income Statement					
Interest income	$213,121	$190,204	$163,296	$127,514	$122,503
Interest expense	39,562	24,966	17,647	10,874	8,937
Net interest income	173,559	165,238	145,649	116,640	113,566
Provision for loan and lease losses	4,413	6,090	4,223	1,942	5,865
Noninterest income excluding gains on investment securities and gain on debt extinguishment	22,893	22,911	20,960	19,090	17,720
Gains on sales of investment securities	—	2,524	370	241	2
Loss on equity securities	(583)	—	—	—	—
Gain on early debt extinguishment	—	—	—	1,830	—
Merger related expenses	464	—	4,103	1,152	—
Long-term debt prepayment fee	—	2,828	—	2,407	—
Noninterest expenses	110,703	101,706	95,814	83,652	79,135
Income before income taxes	80,289	80,049	62,839	48,648	46,288
Income tax provision	16,888	27,469	21,321	16,167	15,159
Net income	$63,401	$52,580	$41,518	$32,481	$31,129
Per-Share Data (1)					
Weighted average shares outstanding:					
Basic	47,578	47,438	42,912	37,844	37,749
Diluted	47,766	47,674	43,114	37,993	37,869
Earnings per share:					
Basic	$1.32	$1.10	$0.96	$0.85	$0.82
Diluted	$1.32	$1.09	$0.95	$0.85	$0.82
Cash dividend per common share	$0.45	$0.40	$0.37	$0.33	$0.29
Book value per common share	$13.14	$12.31	$11.65	$10.57	$10.01
Tangible book value per common share (2)	$10.22	$9.38	$8.70	$7.62	$7.06
Balance Sheet					
Investment securities available for sale and other (5)	$667,840	$658,711	$621,803	$456,436	$467,295
Investment securities held to maturity	153,646	139,685	147,614	116,740	107,976
Loans and leases, net of deferred fees	4,456,733	4,152,720	3,870,598	2,965,200	2,653,826
Goodwill and other identifiable intangible assets	138,201	138,795	139,091	111,519	111,934
Total assets	5,806,093	5,405,639	5,093,131	3,869,550	3,538,325
Total deposits	4,620,670	4,368,748	4,092,835	2,995,572	2,790,819
Total core deposits (3)	3,863,632	3,631,320	3,547,927	2,652,251	2,510,857
Term borrowings	286,145	296,913	365,650	303,143	243,736
Total stockholders' equity	623,739	583,122	550,044	400,516	379,438
Performance Ratios					
Return on average assets	1.15 %	1.00 %	0.90 %	0.89 %	0.92 %
Return on average tangible common equity (2)	13.78 %	12.24 %	12.19 %	11.58 %	12.21 %

Return on average equity	10.59	%	9.25	%	8.75	%	8.28	%	8.48	%
Efficiency ratio (2)(4)	56.09	%	53.40	%	56.74	%	60.94	%	59.48	%
Net interest margin (tax equivalent basis)	3.36	%	3.38	%	3.41	%	3.47	%	3.64	%
Loans to deposits	96.45	%	95.06	%	94.57	%	98.99	%	95.09	%
Capital Ratios										
Common equity to asset ratio	10.74	%	10.79	%	10.80	%	10.35	%	10.72	%
Tangible common equity to tangible assets (2)	8.57	%	8.44	%	8.30	%	7.69	%	7.81	%
Tier 1 leverage ratio (6)	9.39	%	9.12	%	9.07	%	8.70	%	9.08	%
Tier 1 risk-based capital ratio (6)	11.27	%	10.87	%	10.85	%	10.53	%	11.76	%
Total risk-based capital ratio (6)	13.71	%	13.40	%	13.48	%	11.61	%	12.98	%
CET1 ratio (6)	10.62	%	10.18	%	10.11	%	9.54%		NA	

(1) Restated for 5% stock dividend in 2014.

(2) A non-GAAP financial measure. See “Non-GAAP Financial Measures” for a reconciliation of such measures to data calculated in accordance with generally accepted accounting principles.

(3) Core deposits represent all deposits with the exception of time deposits.

(4) Ratio represents noninterest expense, excluding long-term debt prepayment fee, merger related expenses and core deposit amortization, as a percentage of total revenue (calculated on a tax equivalent basis), excluding gains (losses) on securities and gain on debt extinguishment. Total revenue represents net interest income (calculated on a tax equivalent basis) plus noninterest income.

(5) Includes investment in equity securities, Federal Home Loan Bank and other membership stock, at cost.

(6) Beginning March 31, 2015, these ratios were calculated according to the Basel III capital rules that took effect on January 1, 2015.

ITEM 7 – Management's Discussion and Analysis of Financial Condition and Results of Operations.

This section presents a review of Lakeland Bancorp, Inc.'s consolidated results of operations and financial condition. You should read this section in conjunction with the selected consolidated financial data that is presented on the preceding page as well as the accompanying consolidated financial statements and notes to financial statements. As used in the following discussion, the term "Company" refers to Lakeland Bancorp, Inc. and "Lakeland" refers to the Company's wholly owned banking subsidiary, Lakeland Bank.

Statements Regarding Forward-Looking Information

The information disclosed in this document includes various forward-looking statements that are made in reliance upon the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 with respect to credit quality (including delinquency trends and the allowance for loan and lease losses), corporate objectives and other financial and business matters. The words "anticipates," "projects," "intends," "estimates," "expects," "believes," "plans," "may," "will, "could," and other similar expressions are intended to identify such forward-looking statements. The Company cautions that these forward-looking statements are necessarily speculative and speak only as of the date made, and are subject to numerous assumptions, risks and uncertainties, all of which may change over time. Actual results could differ materially from such forward-looking statements.

In addition to the risk factors disclosed in Item 1A in this Annual Report on Form 10-K, the following factors, among others, could cause the Company's actual results to differ materially and adversely from such forward-looking statements: changes in the financial services industry and the U.S. and global capital markets, changes in economic conditions nationally, regionally and in the Company's markets, the nature and timing of actions of the Federal Reserve Board and other regulators, the nature and timing of legislation affecting the financial services industry, government intervention in the U.S. financial system, changes in levels of market interest rates, pricing pressures on loan and deposit products, credit risks of Lakeland's lending and leasing activities, successful implementation, deployment and upgrades of new and existing technology, systems, services and products, customers' acceptance of Lakeland's products and services, competition and failure to realize anticipated efficiencies and synergies from the merger of Highlands Bancorp, Inc. into the Company and Highlands State Bank into Lakeland.

The above-listed risk factors are not necessarily exhaustive, particularly as to possible future events, and new risk factors may emerge from time to time. Certain events may occur that could cause the Company's actual results to be materially different than those described in the Company's periodic filings with the Securities and Exchange Commission. Any statements made by the Company that are not historical facts should be considered to be forward-looking statements. The Company is not obligated to update and does not undertake to update any of its forward-looking statements made herein.

Strategy

The Company, through its wholly owned subsidiary, Lakeland Bank, currently operates 54 banking offices located in Northern and Central New Jersey and Highland Mills, New York. Lakeland offers a broad range of lending, depository, and related financial services to individuals and small to medium sized businesses located in its market areas. Lakeland also offers a broad range of consumer banking services, including lending, depository, safe deposit services and wealth management services.

Lakeland's growth has come from a combination of organic growth and acquisitions. In addition to organic growth, through December 31, 2018, the Company has acquired seven community banks with an aggregate asset total of approximately $1.8 billion at the date of the respective acquisitions. On January 4, 2019, the Company completed its acquisition of Highlands Bancorp, Inc., with four branches and assets totaling approximately $480.8 million. All acquired banks have been merged into Lakeland and their holding companies, if applicable, have been merged into the Company. The Company's strategy is to continue growing both organically and through acquisition should opportunities allow. The Company continues to evaluate opportunities to increase market share by expanding within existing and contiguous markets.

The Company's strategic aim is to provide an adequate return to its shareholders by focusing on profitable growth through services that meet the needs of its customers in its market areas. This will be accomplished by continuing to offer commercial and consumer loan, deposit and other financial product services in a changing economic and technological environment. The Company recognizes that there are more service delivery channels than the traditional branch office and has offered internet banking, mobile banking and cash management services to meet the needs of its business and consumer customers.

The Company's results of operations are primarily dependent upon net interest income, the difference between interest earned on interest-earning assets and the interest paid on interest-bearing liabilities. For information on how interest rate change can influence the Company's net interest income and how the Company manages its net interest income, see "Interest Rate Risk" below.

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The Company generates noninterest income such as income from retail and business account fees, loan servicing fees, loan origination fees, appreciation in the cash surrender value of bank owned life insurance, income from securities sales, fees from wealth management services and investment product sales, income from the origination and sale of residential mortgages and SBA loans and other fees. The Company's operating expenses consist primarily of compensation and benefits expense, occupancy and equipment expense, data processing expense, ATM and debit card expense, marketing and advertising expense and other general and administrative expenses. The Company's results of operations are also affected by general economic conditions, changes in market interest rates, changes in asset quality, changes in asset values, actions of regulatory agencies and government policies.

The Company continues to control its expenses by continually reviewing its ongoing noninterest expense, including evaluating its salary expense, ongoing service contract expense, marketing expenses and other expenses. The Company also controls its expenses by leveraging its technology investments that maximize the efficient delivery of products and services to its customers, which allows it further to evaluate its infrastructure. Through this process, Lakeland Bank has consolidated and closed branches in markets where it may have more branches than necessary, including seven branches in 2016 and three branches in 2018, while permitting it to expand and open a branch in 2017 in an area of opportunity (Highland Mills, New York). The Company expects to open its newest branch in Clifton, New Jersey in March 2019.

Critical Accounting Policies, Judgments and Estimates

The accounting and reporting policies of the Company and Lakeland conform with accounting principles generally accepted in the United States of America ("U.S. GAAP") and predominant practices within the banking industry. The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. These estimates and assumptions also affect reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates. Significant estimates implicit in these financial statements are as follows. For additional accounting policies and detail, refer to Note 1 to the consolidated financial statements included in Item 8 of this report.

Allowance for loan and lease losses. The allowance for loan and lease losses is the estimated amount considered necessary to cover probable and reasonably estimable incurred losses inherent in the loan portfolio at the balance sheet date. In determining the allowance, we make significant estimates and judgments, and, therefore, have identified the allowance as a critical accounting policy. The allowance is established through a provision for loan and lease losses charged against income. Loan principal considered to be uncollectible by management is charged against the allowance.

The allowance for loan and lease losses has been determined in accordance with U.S. GAAP. We are responsible for the timely and periodic determination of the amount of the allowance required. We believe that our allowance is adequate to cover identifiable losses, as well as estimated losses inherent in our portfolio for which certain losses are probable but not specifically identifiable.

The determination of the adequacy of the allowance for loan and lease losses and the periodic provisioning for estimated losses included in the consolidated financial statements is the responsibility of management and the Board of Directors. Management performs a formal quarterly evaluation of the allowance for loan and lease losses. This quarterly process is performed by the credit administration department and approved by the Chief Credit Officer. All supporting documentation with regard to the evaluation process is maintained by the credit administration department. Each quarter, the evaluation along with the supporting documentation is reviewed by the finance department before approval by the Chief Credit Officer. The allowance evaluation is then presented to an Allowance for Loan and Lease Losses committee, which gives final approval to the allowance evaluation before presented to the Board of Directors for their approval.

Additionally, the Company continually evaluates, through its governance process, the development of the allowance for loan and lease losses methodology. During the third quarter of 2017, the Company refined and enhanced its quantitative framework by implementing loss migration periods to determine historical loss rates. It also enhanced its qualitative framework to complement the loss migration historical loss rates. These enhancements were implemented to increase the level of precision in the allowance for loan and lease losses and did not result in a material change in the required allowance for loan and lease losses.

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The methodology employed for assessing the adequacy of the allowance consists of the following criteria:

- The establishment of specific reserve amounts for impaired loans and leases, including purchase-credit impaired loans.
- The establishment of reserves for pools of homogeneous loans and leases not subject to specific review, including impaired loans under $500,000, leases, 1 - 4 family residential mortgages, and consumer loans.

The Company defines impaired loans as all non-accrual loans with recorded investments of $500,000 or greater. Impaired loans also include all loans modified as troubled debt restructurings. Loans and leases are considered impaired when, based on current information and events, it is probable that Lakeland will be unable to collect all amounts due in accordance with the original contractual terms of the loan agreement, including scheduled principal and interest payments.

Impairment is measured based on the present value of expected cash flows discounted at the loan’s effective interest rate, or as a practical expedient, Lakeland may measure impairment based on a loan’s observable market price, or the fair value of the collateral, less estimated costs to sell, if the loan is collateral-dependent. Regardless of the measurement method, Lakeland measures impairment based on the fair value of the collateral when it is determined that foreclosure is probable. Most of Lakeland’s impaired loans are collateral-dependent. Shortfalls in collateral or cash flows are charged-off or specifically reserved for in the period the shortfall is identified. Charge-offs are recommended by the Chief Credit Officer and approved by the Board.

Lakeland groups impaired commercial loans under $500,000 into homogeneous pools and collectively evaluates them.

Interest received on impaired loans and leases may be recorded as interest income. However, if management is not reasonably certain that an impaired loan and lease will be repaid in full, or if a specific time frame to resolve full collection cannot yet be reasonably determined, all payments received are recorded as reductions of principal.

The establishment of reserve amounts for pools of homogeneous loans and leases are based upon the determination of historical loss rates, which are adjusted to reflect current conditions through the use of qualitative factors. The qualitative factors considered by the Company include an evaluation of the results of the Company’s independent loan review function, the Company's reporting capabilities, the adequacy and expertise of Lakeland’s lending staff, underwriting policies, loss histories, trends in the portfolio, delinquency trends, economic and business conditions and capitalization rates. Since many of Lakeland’s loans depend on the sufficiency of collateral as a secondary source of repayment, any adverse trends in the real estate market could affect the underlying values available to protect Lakeland from losses.

Additionally, management determines the loss emergence periods for each loan segment, which are used to define loss migration periods and establish appropriate ranges for qualitative adjustments for each loan segment. The loss emergence period is the estimated time from the date of a loss event (such as a personal bankruptcy) to the actual recognition of the loss (typically via the first partial or full loan charge-off), and is determined based upon a study of our past loss experience by loan segment. All of the factors considered in the analysis of the adequacy of the allowance for loan and lease losses may be subject to change. To the extent actual outcomes differ from management estimates, additional provisions for loan and lease losses may be required that would adversely impact earnings in future periods.

Fair value measurements of investment securities. Fair values of financial instruments are volatile and may be influenced by a number of factors, including market interest rates, prepayment speeds, discount rates, credit ratings and yield curves. Fair values for investment securities are based on quoted market prices, where available. If quoted market prices are not available, fair values are based on the quoted prices of similar instruments or an estimate of fair value by using a range of fair value estimates in the market place as a result of the illiquid market specific to the type of security.

When the fair value of a security is below its amortized cost, and depending on the length of time the condition exists and the extent the fair value is below amortized cost, additional analysis is performed to determine whether an other-than-temporary impairment condition exists. Available for sale and held to maturity securities are analyzed quarterly for possible other-than-temporary impairment. The analysis considers (i) the length of time and the extent to which the fair value has been less than cost, (ii) the financial condition and near-term prospects of the issuer which may include projections of cash flows, and (iii) the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value. Often, the information available to conduct these assessments is limited and rapidly changing, making estimates of fair value subject to judgment. If actual information or conditions are different than estimated, the extent of the impairment of the security may be different than previously estimated, which could have a material effect on the Company’s results of operations and financial condition.

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Use of Non-GAAP Disclosures

Reported amounts are presented in accordance with U.S. GAAP. The Company's management believes that the supplemental non-GAAP information, which consists of measurements and ratios based on tangible equity, tangible assets and the efficiency ratio, which excludes certain items considered to be non-recurring from earnings, is utilized by regulators and market analysts to evaluate a company's financial condition and therefore, such information is useful to investors. These disclosures should not be viewed as a substitute for financial results determined in accordance with U.S. GAAP, nor are they necessarily comparable to non-GAAP performance measures which may be presented by other companies.

Financial Overview

The year ended December 31, 2018 represented a year of continued growth for the Company. As discussed in this management's discussion and analysis:

- Net income was $63.4 million, or $1.32 per diluted share, for the year ended December 31, 2018 compared to net income of $52.6 million, or $1.09 per diluted share, for 2017.
- In 2018, return on average assets was 1.15%, return on average common equity was 10.59% and return on average tangible common equity was 13.78%. This compared to 2017 ratios of return on average assets of 1.00%, return on average common equity of 9.25% and return on average tangible common equity of 12.24%.
- Total loans and leases increased by $304.0 million, or 7%, in 2018 when compared to 2017, with the majority of the increase in the commercial loans secured by real estate category.
- Total deposits increased $251.9 million, or 6%, in 2018 compared to 2017.
- The Company's net interest margin was 3.36% for 2018 compared to 3.38% for 2017.
- Asset quality remains strong with total non-performing assets decreasing to 0.22% of total assets at December 31, 2018 from 0.27% of total assets at December 31, 2017.

During the fourth quarter of 2018, Highlands Bancorp shareholders approved the merger of Highlands Bancorp with and into the Company. This merger, along with the merger of Highlands State Bank with and into Lakeland, was consummated on January 4, 2019, adding approximately $480.8 million in total assets to the Company. For more information, please see Note 2 in Notes to the Consolidated Financial Statements in this Annual Report on Form 10-K.

Net Income

Net income for 2018 was $63.4 million, or $1.32 per diluted share, compared to net income of $52.6 million, or $1.09 per diluted share, in 2017. The major contributing factors to the increase in net income were an increase in net interest income of $8.3 million from 2017 to 2018 due to an increase in interest-earning assets resulting from organic growth and a $10.6 million decrease in our provision for income taxes, principally reflecting the impact of the Tax Cuts and Jobs Act of 2017.

Net Interest Income

Net interest income is the difference between interest income on earning assets and the cost of funds supporting those assets. The Company's net interest income is determined by: (i) the volume of interest-earning assets that it holds and the yields that it earns on those assets, and (ii) the volume of interest-bearing liabilities that it has assumed and the rates that it pays on those liabilities.

Net interest income on a tax equivalent basis for 2018 was $174.0 million, compared to $166.3 million in 2017, resulting primarily from growth in average earning assets of $255.2 million. The net interest margin decreased from 3.38% in 2017 to 3.36% in 2018 primarily as a result of a 34 basis point increase in the cost of interest-bearing liabilities. The increase in the cost of interest-bearing liabilities is primarily attributable to the rise in short-term market interest rates and increasing competition for deposits. The effect of the increase in the cost of funds on net interest income was partially mitigated by an increase in the yield on interest-earning assets of 24 basis points and an increase in interest income earned on free funds (interest-earning assets funded by noninterest-bearing liabilities) resulting from an increase in average noninterest-bearing deposits of $25.1 million. The components of net interest income will be discussed in greater detail below.

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Interest income and expense volume/rate analysis. The following table shows the impact that changes in average balances of the Company's assets and liabilities and changes in average interest rates have had on the Company's net interest income over the past three years. This information for 2018 is presented on a tax equivalent basis assuming a 21% tax rate, while rates for 2016 and 2017 are presented on a tax equivalent basis assuming a 35% tax rate. If a change in interest income or expense is attributable to a change in volume and a change in rate, the amount of the change is allocated proportionately.

	2018 vs. 2017 Increase (Decrease) Due to Change in:		Total Change	2017 vs. 2016 Increase (Decrease) Due to Change in:		Total Change
	Volume	Rate		Volume	Rate	
	(in thousands)					
INTEREST INCOME						
Loans and leases	$11,420	$9,381	$20,801	$19,713	$2,852	$22,565
Taxable investment securities and other	655	1,068	1,723	3,972	(148)	3,824
Tax-exempt investment securities	(657)	(249)	(906)	404	(84)	320
Federal funds sold	(85)	764	679	(96)	407	311
Total interest income	11,333	10,964	22,297	23,993	3,027	27,020
INTEREST EXPENSE						
Savings deposits	2	15	17	1	(38)	(37)
Interest-bearing transaction accounts	279	8,246	8,525	1,334	2,694	4,028
Time deposits	1,782	3,696	5,478	1,040	1,057	2,097
Borrowings	(377)	953	576	(555)	1,786	1,231
Total interest expense	1,686	12,910	14,596	1,820	5,499	7,319
NET INTEREST INCOME	$9,647	$(1,946)	$7,701	$22,173	$(2,472)	$19,701

The following table reflects the components of the Company's net interest income, setting forth for the years presented, (1) average assets, liabilities and stockholders' equity, (2) interest income earned on interest-earning assets and interest expense paid on interest-bearing liabilities, (3) average yields earned on interest-earning assets and average rates paid on interest-bearing liabilities, (4) the Company's net interest spread (i.e., the average yield on interest-earning assets less the average cost of interest-bearing liabilities) and (5) the Company's net interest margin. Rates for 2018 are computed on a tax equivalent basis assuming a 21% tax rate, while rates for 2016 and 2017 are computed on a tax equivalent basis assuming a 35% tax rate.

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	2018			2017			2016		
	Average Balance	Interest Income/ Expense	Average Rates Earned/ Paid	Average Balance	Interest Income/ Expense	Average Rates Earned/ Paid	Average Balance	Interest Income/ Expense	Average Rates Earned/ Paid
	(dollars in thousands)								
ASSETS									
Interest-earning assets:									
Loans and leases (1)	$4,283,401	$193,143	4.51 %	$4,024,257	$172,342	4.28 %	$3,562,882	$149,777	4.20 %
Taxable investment securities and other	736,241	16,710	2.27 %	706,167	14,987	2.12 %	518,905	11,163	2.15 %
Tax-exempt securities	80,456	2,163	2.69 %	104,267	3,069	2.94 %	90,431	2,749	3.04 %
Federal funds sold (2)	82,096	1,559	1.90 %	92,295	880	0.95 %	123,166	569	0.46 %
Total interest-earning assets	5,182,194	213,575	4.12 %	4,926,986	191,278	3.88 %	4,295,384	164,258	3.82 %
Noninterest-earning assets:									
Allowance for loan and lease losses	(36,804)			(33,148)			(31,190)		
Other assets	383,524			373,723			355,622		
TOTAL ASSETS	$5,528,914			$5,267,561			$4,619,816		
LIABILITIES AND STOCKHOLDERS EQUITY									
Interest-bearing liabilities:									
Savings accounts	$489,742	$293	0.06 %	$486,821	$276	0.06 %	$485,004	$313	0.06 %
Interest-bearing transaction accounts	2,301,065	18,711	0.81 %	2,241,259	10,186	0.45 %	1,880,391	6,158	0.33 %
Time deposits	778,180	11,616	1.49 %	623,257	6,138	0.98 %	506,487	4,041	0.80 %
Borrowings	340,414	8,942	2.63 %	357,978	8,366	2.34 %	393,149	7,135	1.81 %
Total interest-bearing liabilities	3,909,401	39,562	1.01 %	3,709,315	24,966	0.67 %	3,265,031	17,647	0.54 %
Noninterest-bearing liabilities:									
Demand deposits	984,445			959,298			852,629		
Other liabilities	36,541			30,268			27,616		
Stockholders' equity	598,527			568,680			474,540		
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$5,528,914			$5,267,561			$4,619,816		
		174,013	3.11 %		166,312	3.21 %		146,611	3.28 %

Net interest income/spread			
Tax equivalent basis adjustment	454	1,074	962
NET INTEREST INCOME	$173,559	$165,238	$145,649
Net interest margin (3)	3.36 %	3.38 %	3.41 %

(1) Includes non-accrual loans, the effect of which is to reduce the yield earned on loans, loans held for sale, and deferred loan fees.
(2) Includes interest-bearing cash accounts.
(3) Net interest income on a tax equivalent basis divided by interest-earning assets.

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Interest income on a tax equivalent basis increased from $191.3 million in 2017 to $213.6 million in 2018, an increase of $22.3 million, or 12%. The increase in interest income was primarily a result of organic growth in loans as well as an increase in interest rates caused by the recent increases in the federal funds rate and prime rate. The average balance of loans and leases increased $259.1 million compared to 2017, while the yield on average loans and leases of 4.51% in 2018 was 23 basis points greater than 2017. The yield on average taxable investment securities increased 15 basis points, while the yield on tax-exempt investment securities decreased 25 basis points compared to 2017. The decrease in yield on average tax-exempt investment securities was due primarily to a reduction in tax equivalent income resulting from the Tax Cuts and Jobs Act of 2017.

Interest income on a tax equivalent basis increased from $164.3 million in 2016 to $191.3 million in 2017, an increase of $27.0 million, or 16%. The increase in interest income was primarily a result of the full-year impact of the 2016 Harmony Bank acquisition as well as organic growth in loans, as the average balance of loans and leases increased $461.4 million compared to 2016. The yield on average loans and leases of 4.28% in 2017 was 8 basis points greater than 2016. The yield on average taxable investment securities and tax-exempt investment securities decreased by 3 and 10 basis points, respectively, compared to 2016. Interest on taxable investment securities in 2016, included $358,000 in income on called U.S. government agency securities. The decrease in yield on tax-exempt investment securities was primarily due to securities maturing at higher rates and new purchases of short-term securities at lower rates.

Total interest expense increased from $25.0 million in 2017 to $39.6 million in 2018, an increase of $14.6 million, or 58%, primarily due to the increasing interest rate environment. The cost of average interest-bearing liabilities increased from 0.67% in 2017 to 1.01% in 2018 primarily due to an increasingly competitive market for deposits resulting from a higher interest rate environment as well as an increase in the cost of borrowing. The cost of interest-bearing transaction accounts and time deposits increased by 36 basis points and 51 basis points, respectively, while the cost of borrowings increased 29 basis points compared to 2017. The increase in the cost of interest-bearing transaction accounts was due primarily to increases in yields on public funds deposits as many of the accounts are indexed to the Fed Funds rate. A money market deposit account promotion also contributed to the increase in the cost of interest-bearing transaction accounts. Average time deposits increased from $623.3 million in 2017 to $778.2 million in 2018 primarily as a result of the Company's certificate of deposit promotion beginning in the last half of 2017.

Total interest expense increased from $17.6 million in 2016 to $25.0 million in 2017, an increase of $7.3 million, or 41%, primarily due to the increasing rate environment. The cost of average interest-bearing liabilities increased from 0.54% in 2016 to 0.67% in 2017. The increase in the cost of interest-bearing liabilities was due to an increase in the cost of borrowings and an increasingly competitive market for deposits. The 53 basis point increase in the cost of borrowings was due primarily to a $75.0 million issuance of subordinated debt in September 2016 bearing a rate of 5.125%. During 2017, average interest-bearing transaction accounts and time deposits increased 19% and 23%, respectively, while the yield for those categories increased by 12 basis points and 18 basis points, respectively.

Provision for Loan and Lease Losses

In determining the provision for loan and lease losses, management considers national and local economic conditions; trends in the portfolio including orientation to specific loan types or industries; experience, ability and depth of lending management in relation to the complexity of the portfolio; adequacy and adherence to policies, procedures and practices; levels and trends in delinquencies, impaired loans and leases and net charge-offs and the results of independent third party loan reviews.

The provision for loan and lease losses decreased from $6.1 million in 2017 to $4.4 million in 2018. The decreased provision during 2018 was primarily a result of continued low charge-off rates. For more information, please see the discussion under "Risk Elements" below.

The provision for loan and lease losses increased from $4.2 million in 2016 to $6.1 million in 2017. The increased provision during 2017 was primarily a result of commercial real estate loan growth and higher charge-offs in commercial construction loans.

Noninterest Income

Noninterest income of $22.3 million in 2018 decreased by $3.1 million compared to 2017. Included in noninterest income in 2018, was a $583,000 loss on equity securities compared to $2.5 million in gains on sales of investment securities in 2017. In 2018 there was a $561,000 loss on sales of premises and equipment compared to $838,000 in gains in 2017. Noninterest income in 2017 also included a $342,000 gain on the payoff of an acquired loan. Noninterest income for 2018 had increases in commissions and fees of $684,000 and an increase in income on bank owned life insurance of $902,000, which included death benefit income. Gains on sale of loans decreased $507,000 in 2018, compared to 2017. Noninterest income represented 11% of total revenue in 2018. Total revenue is defined as net interest income plus noninterest income.

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Noninterest income of $25.4 million in 2017 increased by $4.1 million compared to 2016. Included in noninterest income in 2017 was $2.5 million in gains on sales of investment securities compared to $370,000 for the same period last year. Service charges on deposit accounts of $10.7 million in 2017 was $583,000 higher than 2016 due primarily to changes in the fee structure on deposit accounts. Commissions and fees of $4.9 million in 2017 increased $509,000 compared to 2016 due primarily to increases in commercial loan fees and credit card related merchant service fees. Gains on sales of loans in 2017 of $1.8 million decreased $287,000 compared to 2016 due primarily to a reduced volume of sales. Income on bank owned life insurance at $2.4 million decreased $208,000 compared to 2016 due primarily to higher death benefits received in 2016. Other income of $3.1 million in 2017 was $1.4 million higher than 2016 due primarily to a $380,000 increase in gains on sales of other real estate owned, a $324,000 gain on the payoff of an acquired loan and $881,000 in gains on the sales of three former branches. Noninterest income represented 13% of total revenue in 2017.

Noninterest Expense

Noninterest expense totaling $111.2 million increased $6.6 million in 2018 from 2017. During 2017, the Company incurred $2.8 million in long-term debt prepayment penalties, and in 2018, the Company incurred $464,000 in merger related expenses. Excluding the 2017 long-term debt prepayment fees and 2018 merger expenses, the resulting $9.0 million net increase was primarily due to a $7.4 million increase in salary and employee benefit costs resulting from additions to our staff to support continued growth, as well as normal merit increases and higher benefit costs. The Company also recorded a life insurance payout related to a BOLI death benefit received in the third quarter of 2018. Data processing expense was $3.6 million, an increase of $1.6 million resulting from the Company's expansion and improvement of its digital infrastructure. Stationery, supplies and postage and marketing expense decreased $172,000 and $238,000, respectively, while telecommunication expense and ATM and debit card expense increased $162,000 and $144,000, respectively.

Noninterest expense totaling $104.5 million increased $4.6 million in 2017 from 2016. During 2017, the Company incurred $2.8 million in long-term debt prepayment penalties, and in 2016, the Company incurred $4.1 million in merger related expenses. Salaries and employee benefits expense of $61.2 million increased $5.1 million from 2016, primarily due to the addition of Harmony employees during the second half of 2016 and year-over-year increases in employee salary and benefit costs. FDIC insurance expense of $1.6 million in 2017 decreased $671,000 compared to 2016, due primarily to decreased non-performing loans and increased capital levels. Data processing expense of $2.0 million increased $102,000 resulting from increases in the cost of mobile banking and the addition of the Harmony branches in the second half of 2016.

The efficiency ratio, a non-GAAP measure, expresses the relationship between noninterest expense (excluding long-term debt prepayment fees, merger related expenses and core deposit amortization) to total tax-equivalent revenue (excluding gains (losses) on securities and gain on debt extinguishment). In 2018, the Company's efficiency ratio on a tax equivalent basis was 56.09% compared to 53.40% in 2017. The efficiency ratio was 56.74% in 2016.

	For the Year Ended December 31,				
	2018	2017	2016	2015	2014
	(dollars in thousands)				
Calculation of Efficiency Ratio (a Non-GAAP Measure)					
Total noninterest expense	$111,167	$104,534	$99,917	$87,211	$79,135
Less:					
Amortization of core deposit intangibles	(594)	(654)	(734)	(415)	(464)
Merger related expenses	(464)	—	(4,103)	(1,152)	—
Long-term debt prepayment fee	—	(2,828)	—	(2,407)	—
Noninterest expense, as adjusted	$110,109	$101,052	$95,080	$83,237	$78,671
Net interest income	$173,559	$165,238	$145,649	$116,640	$113,566
Noninterest income	22,310	25,435	21,330	21,161	17,722
Total revenue	195,869	190,673	166,979	137,801	131,288

Plus: Tax-equivalent adjustment on municipal securities	454	1,074	962	857	972
Less: Gains on sales of investment securities and debt extinguishment	—	(2,524)	(370)	(2,071)	(2)
Total revenue, as adjusted	$196,323	$189,223	$167,571	$136,587	$132,258
Efficiency ratio (Non-GAAP)	56.09 %	53.40 %	56.74 %	60.94 %	59.48 %

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Income Taxes

The Company’s effective income tax rate was 21.0%, 34.3% and 33.9%, in the years ended December 31, 2018, 2017 and 2016, respectively. The effective tax rate decrease from 2017 to 2018 was primarily due to the change in tax rates resulting from the Tax Cuts and Jobs Act of 2017 (the "Tax Act") and the changes in New Jersey tax law during 2018. The effective tax rate increase from 2016 to 2017 was primarily as a result of a decrease in tax advantaged items as a percent of pre-tax income.

Financial Condition

Total assets increased from $5.41 billion at December 31, 2017 to $5.81 billion at December 31, 2018, an increase of $400.5 million, or 7%. Loans, net of deferred fees, were $4.46 billion, an increase of $304.0 million, or 7%, from $4.15 billion at December 31, 2017. Total deposits were $4.62 billion, an increase of $251.9 million, or 6%, from December 31, 2017. Total assets at year-end 2017 increased $312.5, or 6%, from year-end 2016.

Loans and Leases

Lakeland primarily serves New Jersey, the Hudson Valley region in New York and the surrounding areas. Its equipment finance division serves a broader market with a primary focus on the Northeast.

Gross loans and leases of $4.46 billion increased by $303.8 million from December 31, 2017, primarily in the commercial loans secured by real estate category. Commercial loans secured by real estate increased $226.6 million, or 8%, from December 31, 2017 to December 31, 2018. Leases and real estate construction loans increased $12.9 million, or 17%, and $54.6 million, or 21%, respectively. Gross loans and leases of $4.16 billion at December 31, 2017 increased by $282.8 million from December 31, 2016, primarily in the commercial loans secured by real estate category.

The following table sets forth the classification of Lakeland’s gross loans and leases by major category as of December 31 for each of the last five years:

	December 31,				
	2018	2017	2016	2015	2014
	(in thousands)				
Commercial, secured by real estate	$3,057,779	$2,831,184	$2,556,601	$1,761,589	$1,529,761
Commercial, industrial and other	336,735	340,400	350,228	307,044	238,252
Leases	87,925	75,039	67,016	56,660	54,749
Real estate - residential mortgage	329,854	322,880	349,581	389,692	431,190
Real estate - construction	319,545	264,908	211,109	118,070	64,020
Home equity and consumer	328,609	322,269	339,360	334,891	337,642
Total loans and leases	4,460,447	4,156,680	3,873,895	2,967,946	2,655,614
Deferred fees	(3,714)	(3,960)	(3,297)	(2,746)	(1,788)
Loans and leases, net	$4,456,733	$4,152,720	$3,870,598	$2,965,200	$2,653,826

At December 31, 2018, there were no concentrations of loans or leases exceeding 10% of total loans and leases outstanding other than loans that are secured by real estate. Loan concentrations are considered to exist when there are amounts loaned to a multiple number of borrowers engaged in similar activities which would cause them to be similarly impacted by economic or other related conditions.

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The following table sets forth maturities and sensitivity to changes in interest rates in commercial loans in Lakeland's loan portfolio at December 31, 2018:

	Within One Year	After One but Within Five Years	After Five Years	Total
	(in thousands)			
Commercial, secured by real estate	$217,243	$590,110	$2,250,426	$3,057,779
Commercial, industrial and other	170,774	87,101	78,860	336,735
Real estate - construction	117,996	86,573	114,976	319,545
Total	$506,013	$763,784	$2,444,262	$3,714,059
Predetermined rates	$91,403	$572,698	$284,681	$948,782
Floating or adjustable rates	414,610	191,086	2,159,581	2,765,277
Total	$506,013	$763,784	$2,444,262	$3,714,059

Risk Elements

Commercial loans and leases are placed on a non-accrual status with all accrued interest and unpaid interest reversed if (a) because of the deterioration in the financial position of the borrower, they are maintained on a cash basis (which means payments are applied when and as received rather than on a regularly scheduled basis), (b) payment of all contractual principal and interest is not expected, or (c) principal and interest have been in default for a period of 90 days or more unless the obligation is both well-secured and in process of collection. Residential mortgage loans and closed-end consumer loans are placed on non-accrual status at the time principal and interest have been in default for a period of 90 days or more, except where there exists sufficient collateral to cover the defaulted principal and interest payments, and the loans are well-secured and in the process of collection. Open-end consumer loans secured by real estate are generally placed on non-accrual status and reviewed for charge-off when principal and interest payments are four months in arrears unless the obligations are well-secured and in the process of collection. Interest thereafter on such charged-off consumer loans is taken into income when received only after full recovery of principal. As a general rule, a non-accrual asset may be restored to accrual status when none of its principal or interest is due and unpaid and satisfactory payments have been received for a sustained period (usually six months), or when it otherwise becomes well-secured and in the process of collection.

The following schedule sets forth certain information regarding Lakeland's non-accrual loans (including troubled debt restructurings that are on non-accrual) and past due loans and leases and other real estate owned and other repossessed assets as of December 31, for each of the last five years:

	December 31,				
	2018	2017	2016	2015	2014
	(dollars in thousands)				
Commercial, secured by real estate	$7,192	$5,890	$10,413	$10,446	$7,424
Commercial, industrial and other	1,019	184	167	103	308
Leases	501	144	153	316	88
Real estate - residential mortgage	1,986	3,860	6,048	8,664	9,246
Real estate - construction	—	1,472	1,472	—	188
Home equity and consumer	1,432	2,105	2,151	3,167	3,415
Total non-accrual loans and leases	12,130	13,655	20,404	22,696	20,669
Other real estate and other repossessed assets	830	843	1,072	983	1,026
Total non-performing assets	$12,960	$14,498	$21,476	$23,679	$21,695
Non-performing assets as a percentage of total assets	0.22 %	0.27 %	0.42 %	0.61 %	0.61 %
Loans and leases past due 90 days or more and still accruing	$—	$200	$10	$331	$66
Troubled debt restructurings, still accruing	$9,293	$11,462	$8,802	$10,108	$10,579

Non-accrual loans and leases decreased to $12.1 million on December 31, 2018 from $13.7 million at December 31, 2017 due primarily to residential mortgages and real estate construction loans, which decreased $1.9 million or 49% and $1.5 million or 100%, respectively. Partially offsetting these reductions in non-accrual balances was commercial, secured by real estate which increased $1.3 million, or 22%.

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Non-accruals include 3 loan relationships between $500,000 and $1.0 million totaling $1.8 million, and 3 loan relationships exceeding $1.0 million totaling $3.7 million. All non-accrual loans and leases are in various stages of litigation, foreclosure, or workout. Non-accrual loans included $3.6 million and $2.7 million in troubled debt restructurings as of December 31, 2018 and 2017, respectively.

At December 31, 2018 and 2017, Lakeland had $9.3 million and $11.5 million, respectively, in loans that were restructured and still accruing. Restructured loans that are still accruing are those loans where Lakeland has granted concessions to the borrower in payment terms, in rate and/or in maturity as a result of the financial difficulties of the borrower where the borrower has demonstrated the ability to repay based on the modified terms of the loan.

For 2018, the gross interest income that would have been recorded, had the loans and leases classified at year-end as impaired been performing in conformance with their original terms, was approximately $1.1 million. The amount of interest income actually recorded on those loans and leases for 2018 was $592,000. The resultant loss of $505,000 for 2018 compares with prior year losses of $785,000 for 2017 and $1.0 million for 2016.

As of December 31, 2018, Lakeland had impaired loans and leases totaling $19.7 million (consisting primarily of non-accrual and restructured loans and leases), compared to $22.6 million at December 31, 2017. The valuation allowance of these loans and leases is based primarily on the fair value of the underlying collateral. Based upon such evaluation, $338,000 has been allocated to the allowance for loan and lease losses for impairment at December 31, 2018 compared to $505,000 at December 31, 2017. At December 31, 2018, Lakeland also had $41.8 million in loans and leases that were rated substandard that were not classified as non-performing or impaired compared to $28.3 million at December 31, 2017.

There were no additional loans or leases at December 31, 2018, other than those designated non-performing, impaired or substandard, where Lakeland was aware of any credit conditions of any borrowers that would indicate a strong possibility of the borrowers not complying with the present terms and conditions of repayment and which may result in such loans or leases being included as non-accrual, past due or renegotiated at a future date.

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The following table sets forth for each of the five years ended December 31, 2018, the historical relationships among the amount of loans and leases outstanding, the allowance for loan and lease losses, the provision for loan and lease losses, the amount of loans and leases charged off and the amount of loan and lease recoveries:

	Years Ended December 31,				
	2018	2017	2016	2015	2014
	(dollars in thousands)				
Allowance balance, beginning of the year	$35,455	$31,245	$30,874	$30,684	$29,821
Loans and leases charged off:					
Commercial, secured by real estate	(421)	(762)	(410)	(1,821)	(2,282)
Commercial, industrial and other	(1,452)	(477)	(796)	(205)	(999)
Leases	(507)	(305)	(366)	(548)	(597)
Real estate - residential mortgage	(131)	(441)	(1,103)	(375)	(827)
Real estate - construction	(248)	(609)	—	(20)	(25)
Home equity and consumer	(588)	(852)	(1,980)	(1,511)	(2,697)
Total loans and leases charged off	(3,347)	(3,446)	(4,655)	(4,480)	(7,427)
Recoveries:					
Commercial, secured by real estate	468	396	297	2,221	999
Commercial, industrial and other	317	172	202	183	1,039
Leases	23	59	31	26	19
Real estate - residential mortgage	10	5	8	63	42
Real estate - construction	17	31	18	106	106
Home equity and consumer	332	903	247	129	220
Total recoveries	1,167	1,566	803	2,728	2,425
Net charge-offs	(2,180)	(1,880)	(3,852)	(1,752)	(5,002)
Provision for loan and lease losses	4,413	6,090	4,223	1,942	5,865
Allowance balance, end of year	$37,688	$35,455	$31,245	$30,874	$30,684
Net charge-offs as a percentage of average loans and leases outstanding	0.05%	0.05%	0.11%	0.06%	0.19%
Allowance as a percentage of year-end total loans and leases outstanding	0.84%	0.85%	0.81%	1.04%	1.16%
Allowance as a percent of non-accrual loans and leases	310.70%	259.65%	153.13%	136.03%	148.45%

The ratio of the allowance for loan and lease losses to loans and leases outstanding reflects management’s evaluation of the underlying credit risk inherent in the loan portfolio as discussed above in “Critical Accounting Policies, Judgments and Estimates – Allowance for Loan and Lease Losses.”

Non-accrual loans and leases decreased from $13.7 million on December 31, 2017 to $12.1 million on December 31, 2018 and the allowance for loan and lease losses was 0.84% of total loans and leases on December 31, 2018 compared to 0.85% of total loans and leases on December 31, 2017. Management believes, based on appraisals and estimated selling costs, that the majority of its non-performing loans are well secured and that the reserves on its non-performing loans are adequate. Based upon the process employed and giving recognition to all accompanying factors related to the loan and lease portfolio, management considers the allowance for loan and lease losses to be adequate at December 31, 2018.

The overall balance of the allowance for loan and lease losses of $37.7 million at December 31, 2018 increased $2.2 million from December 31, 2017, an increase of 6%. The change of the allowance within segments of the loan portfolio reflects changes in the non-performing loans and charge-off statistics within each segment as well as the level of growth within each segment. Loan reserves are based on a combination of historical charge-off experience, estimating the appropriate loss emergence and pre-emergence periods and assigning qualitative factors based on general economic conditions and specific bank portfolio characteristics.

The increase in the allowance from December 31, 2017 to December 31, 2018 within the commercial, secured by real estate segment and in the leasing segment reflects loan growth in these segments, as well as an increase in non-performing loans. The decrease in the allowance in commercial, industrial and other loans relates to the migration of loans into lower risk rating categories.

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The following table sets forth the allowance for loan and lease losses allocated by loan category and the percent of loans in each category to total loans at the dates indicated. The allowance for loan and lease losses allocated to each category is not necessarily indicative of future losses in any particular category and does not restrict the use of the allowance to absorb losses in other categories.

	December 31, 2018		2017		2016		2015		2014	
	Allowance	% of Loans in Each Category	Allowance	% of Loans in Each Category	Allowance	% of Loans in Each Category	Allowance	% of Loans in Each Category	Allowance	% of Loans in Each Category
	(dollars in thousands)									
Commercial, secured by real estate	$27,881	68.5 %	$25,704	68.0 %	$21,223	66.1 %	$20,223	59.4 %	$13,577	57.6 %
Commercial, industrial and other	1,742	7.5 %	2,313	8.2 %	1,723	9.0 %	2,637	10.3 %	3,196	9.0 %
Leases	987	2.0 %	630	1.8 %	548	1.7 %	460	1.9 %	582	2.1 %
Real estate - residential mortgage	1,566	7.4 %	1,557	7.8 %	1,964	9.0 %	2,588	13.1 %	4,020	16.2 %
Real estate - construction	3,015	7.2 %	2,731	6.4 %	2,352	5.4 %	1,591	4.0 %	553	2.4 %
Home equity and consumer	2,497	7.4 %	2,520	7.8 %	3,435	8.8 %	3,375	11.3 %	6,333	12.7 %
Unallocated	—		—		—		—		2,423	
	$37,688	100.0 %	$35,455	100.0 %	$31,245	100.0 %	$30,874	100.0 %	$30,684	100.0 %

Investment Securities

The Company has classified its investment securities into the available for sale and held to maturity categories based on its intent and ability to hold the securities to maturity. The Company has no investment securities classified as trading securities.

The following table sets forth the carrying value of the Company's investment securities, both available for sale and held to maturity, as of December 31 for each of the last three years. Investment securities available for sale are stated at fair value while securities held for maturity are stated at cost, adjusted for amortization of premiums and accretion of discounts.

	December 31, 2018	2017	2016
	(in thousands)		
U.S. Treasury and U.S. government agencies	$173,952	$180,670	$150,912
Mortgage-backed securities, residential	502,003	469,245	442,244
Mortgage-backed securities, multifamily	22,803	12,034	12,246
Obligations of states and political subdivisions	83,414	94,638	119,610
Equity securities	15,921	18,089	21,882
Debt securities	10,092	11,144	7,424
	$808,185	$785,820	$754,318

The Company also does not own any interests in any hedge funds or private equity funds that are designated "covered funds" under the Volcker Rule issued in December 2013. All of the Company's mortgage-backed securities are issued by U.S. Government or U.S. Government sponsored entities.

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The following tables set forth the maturity distribution and weighted average yields (calculated on the basis of the stated yields to maturity, considering applicable premium or discount), on a fully taxable equivalent basis, of investment securities as of December 31, 2018, at book value:

Available for Sale	Within One Year	Over One but Within Five Years	Over Five but Within Ten Years	After Ten Years	Total
	(dollars in thousands)				
U.S. Treasury and U.S. government agencies					
Amount	$27,823	$79,876	$15,613	$17,615	$140,927
Yield	1.37 %	1.83 %	2.41 %	2.68 %	1.91 %
Mortgage-backed securities, residential					
Amount	—	7,293	68,910	349,941	426,144
Yield	— %	2.16 %	2.19 %	2.57 %	2.50 %
Mortgage-backed securities, multifamily					
Amount	4,964	4,927	9,081	1,978	20,950
Yield	1.73 %	2.43 %	3.10 %	3.46 %	2.64 %
Obligations of states and political subdivisions					
Amount	2,791	22,878	19,403	433	45,505
Yield	3.33 %	2.53 %	2.46 %	2.93 %	2.55 %
Debt securities					
Amount	—	—	5,092	—	5,092
Yield	— %	— %	5.82 %	— %	5.82 %
Total securities					
Amount	$35,578	$114,974	$118,099	$369,967	$638,618
Yield	1.72 %	2.01 %	2.49 %	2.58 %	2.40 %

Held to Maturity	Within One Year	Over One but Within Five Years	Over Five but Within Ten Years	After Ten Years	Total
	(dollars in thousands)				
U.S. Treasury and U.S. government agencies					
Amount	$—	$21,252	$11,773	$—	$33,025
Yield	— %	2.03 %	2.28 %	— %	2.12 %
Mortgage-backed securities, residential					
Amount	—	1	2,345	73,513	75,859
Yield	— %	5.83 %	2.37 %	2.87 %	2.85 %
Mortgage-backed securities, multifamily					
Amount	—	1,058	795	—	1,853
Yield	— %	0.20 %	2.37 %	— %	1.13 %
Obligations of states and political subdivisions					
Amount	7,061	20,851	6,979	3,018	37,909
Yield	2.92 %	2.55 %	2.87 %	2.78 %	2.69 %
Debt securities					
Amount	—	—	5,000	—	5,000
Yield	— %	— %	5.05 %	— %	5.05 %
Total securities					
Amount	$7,061	$43,162	$26,892	$76,531	$153,646
Yield	2.92 %	2.23 %	2.96 %	2.87 %	2.71 %

Other Assets

Assets included within "other assets" on the Company's balance sheet increased from $35.6 million at December 31, 2017 to $42.3 million at December 31, 2018 primarily due to a $5.6 million increase in swap assets.

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Deposits

Total deposits increased from $4.37 billion at December 31, 2017 to $4.62 billion at December 31, 2018, an increase of $251.9 million, or 6%. Noninterest-bearing deposits decreased $17.1 million, or 2%, to $950.2 million. Savings and interest-bearing transaction accounts and time deposits increased $249.4 million and $19.6 million, respectively.

Total deposits increased from $4.09 billion at December 31, 2016 to $4.37 billion at December 31, 2017, an increase of $275.9 million, or 7%.

The average amount of deposits and the average rates paid on deposits for the years indicated are summarized in the following table:

	Year Ended December 31,					
	2018		2017		2016	
	Average Balance	Average Rate	Average Balance	Average Rate	Average Balance	Average Rate
	(dollars in thousands)					
Noninterest-bearing demand deposits	$984,445	— %	$959,298	— %	$852,629	— %
Interest-bearing transaction accounts	2,301,065	0.81 %	2,241,259	0.45 %	1,880,391	0.33 %
Savings	489,742	0.06 %	486,821	0.06 %	485,004	0.06 %
Time deposits	778,180	1.49 %	623,257	0.98 %	506,487	0.80 %
Total	$4,553,432	0.67 %	$4,310,635	0.38 %	$3,724,511	0.28 %

As of December 31, 2018, the aggregate amount of outstanding time deposits issued in amounts of greater than $250,000, broken down by time remaining to maturity, was as follows (in thousands):

Maturity	
Within 3 months	$45,961
Over 3 through 6 months	45,557
Over 6 through 12 months	60,574
Over 12 months	15,209
Total	$167,301

Derivatives

Lakeland enters into interest rate swaps (“swaps”) with loan customers to provide a facility to mitigate the fluctuations in the variable rate on the respective loans. These swaps are matched in offsetting terms to swaps that Lakeland enters into with an outside third party. The swaps are reported at fair value in other assets or other liabilities. Lakeland’s swaps qualify as derivatives, but are not designated as hedging instruments; thus any net gain or loss resulting from changes in the fair value is recognized in other noninterest income.

In 2016, the Company entered into two cash flow hedges in order to hedge the variable cash outflows associated with its subordinated debentures. The notional value of these hedges was $30.0 million. The Company’s objectives in using the cash flow hedge is to add stability to interest expense and to manage its exposure to interest rate movements. The Company used interest rate swaps designated as cash flow hedges which involved the receipt of variable amounts from a counterparty in exchange for the Company making fixed-rate payments over the life of the agreements without exchange of the underlying notional amount. In these particular hedges the Company is paying a third party an average of 1.10% in exchange for a payment at 3 month LIBOR over a five year period. The effective portion of changes in the fair value of derivatives designated and that qualify as cash flow hedges are recorded in accumulated other comprehensive income and are subsequently reclassified into earnings in the period that the hedged forecasted transaction affects earnings. During 2018, the Company did not record any hedge ineffectiveness.

Further discussion of Lakeland’s financial derivatives is set forth in Note 19 to the Consolidated Financial Statements.

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Liquidity

"Liquidity" measures whether an entity has sufficient cash flow to meet its financial obligations and commitments on a timely basis. The Company is liquid when its subsidiary bank has the cash available to meet the borrowing and cash withdrawal requirements of customers and the Company can pay for current and planned expenditures and satisfy its debt obligations.

Lakeland funds loan demand and operation expenses from several sources:

- Net income. Cash provided by operating activities was $79.4 million in 2018 compared to $67.5 million and $50.1 million in 2017 and 2016, respectively.
- Deposits. Lakeland can offer new products or change its rate structure in order to increase deposits. In 2018, Lakeland generated $251.9 million in deposit growth, compared to $275.9 million in 2017.
- Sales of securities and overnight funds. At year-end 2018, the Company had $638.6 million in securities designated "available for sale." Of these securities, $421.2 million was pledged to secure public deposits and for other purposes required by applicable laws and regulations.
- Repayments on loans and leases can also be a source of liquidity to fund further loan growth.
- Overnight credit lines. As a member of the Federal Home Loan Bank of New York ("FHLB"), Lakeland has the ability to borrow overnight based on the market value of collateral pledged. Lakeland had no overnight borrowings from the FHLB on December 31, 2018. Lakeland also has overnight federal funds lines available for it to borrow up to $210.0 million. Lakeland had borrowings against these lines of $192.1 million at December 31, 2018. Lakeland also has the ability to utilize a line of credit from the FHLB to secure a portion of its public deposits. Lakeland may also borrow from the discount window of the Federal Reserve Bank of New York based on the market value of collateral pledged. Lakeland had no borrowings with the Federal Reserve Bank of New York as of December 31, 2018.
- Other borrowings. Lakeland can also generate funds by utilizing long-term debt or securities sold under agreements to repurchase that would be collateralized by security or mortgage collateral. At times the market values of securities collateralizing our securities sold under agreements to repurchase may decline due to changes in interest rates and may necessitate our lenders to issue a "margin call" which requires the Company to pledge additional collateral to meet that margin call. For more information regarding the Company's borrowings, see Note 8 to the Consolidated Financial Statements.

Management and the Board monitor the Company's liquidity through the Asset/Liability Committee, which monitors the Company's compliance with certain regulatory ratios and other various liquidity guidelines.

The cash flow statements for the periods presented provide an indication of the Company's sources and uses of cash, as well as an indication of the ability of the Company to maintain an adequate level of liquidity. Cash and cash equivalents totaling $208.6 million on December 31, 2018, increased $65.7 million from December 31, 2017. Operating activities provided $79.4 million in net cash. Investing activities used $342.6 million in net cash, primarily reflecting an increase in loans and leases. Financing activities provided $328.8 million in net cash primarily reflecting a net increase in deposits of $252.3 million, and an increase in federal funds purchased and securities sold under agreements to repurchase of $109.0 million, partially offset by dividends paid and net repayments of other borrowings of $21.3 million and $10.7 million, respectively.

The Company's management believes that its current level of liquidity is sufficient to meet its current and anticipated operational needs, including current loan commitments, deposit maturities and other obligations. This constitutes a forward-looking statement under the Private Securities Litigation Reform Act of 1995. Actual results could differ materially from anticipated results due to a variety of factors, including uncertainties relating to general economic conditions; unanticipated decreases in deposits; changes in or failure to comply with governmental regulations; and uncertainties relating to the analysis of the Company's assessment of rate sensitive assets and rate sensitive liabilities and the extent to which market factors indicate that a financial institution such as Lakeland should match such assets and liabilities.

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Off Balance Sheet Arrangements and Aggregate Contractual Obligations

The following table sets forth contractual obligations and other commitments representing required cash outflows as of December 31, 2018. Interest on subordinated debentures and other borrowings is calculated based on current contractual interest rates.

	Payment Due Period				
	Total	Within One Year	After One but Within Three Years	After Three but Within Five Years	After Five Years
	(in thousands)				
Minimum annual rentals or noncancellable operating leases	$28,559	$3,191	$ 5,921	$ 4,805	$ 14,642
Benefit plan commitments	5,658	307	793	818	3,740
Remaining contractual maturities of time deposits	757,038	568,350	144,579	44,109	—
Subordinated debentures	105,027	—	—	—	105,027
Loan commitments and lines of credit	973,709	667,925	135,444	19,118	151,222
Other borrowings	181,118	40,264	100,851	40,003	—
Interest on other borrowings (1)	65,110	8,996	15,722	12,334	28,058
Standby letters of credit	21,585	21,061	444	—	80
Total	$2,137,804	$1,310,094	$ 403,754	$ 121,187	$ 302,769

(1) Includes interest on other borrowings and subordinated debentures at a weighted rate of 3.26%.

Interest Rate Risk

Closely related to the concept of liquidity is the concept of interest rate sensitivity (i.e., the extent to which assets and liabilities are sensitive to changes in interest rates). As a financial institution, the Company's potential interest rate volatility is a primary component of its market risk. Fluctuations in interest rates will ultimately impact the level of income and expense recorded on a large portion of the Company's assets and liabilities, and the market value of all interest-earning assets, other than those which possess a short term to maturity. Based upon the Company's nature of operations, the Company is not subject to foreign currency exchange or commodity price risk. The Company does not own any trading assets.

The Company's net income is largely dependent on net interest income. Net interest income is susceptible to interest rate risk to the extent that interest-bearing liabilities mature or reprice on a different basis than interest-earning assets. For example, when interest-bearing liabilities mature or reprice more quickly than interest-earning assets, an increase in market interest rates could adversely affect net interest income. Conversely, when interest-earning assets reprice more quickly than interest-bearing liabilities, an increase in market interest rates could increase net interest income.

The Company's Board of Directors has adopted an Asset/Liability Policy designed to stabilize net interest income and preserve capital over a broad range of interest rate movements. This policy outlines guidelines and ratios dealing with, among others, liquidity, volatile liability dependence, investment portfolio composition, loan portfolio composition, loan-to-deposit ratio and gap analysis ratio. Key quantitative measurements include the percentage change of net interest income in various interest rate scenarios (net interest income at risk) and changes in the market value of equity in various rate environments (net portfolio value at risk). The Company's performance as compared to the Asset/Liability Policy is monitored by its Risk Committee. In addition, to effectively administer the Asset/Liability Policy and to monitor exposure to fluctuations in interest rates, the Company maintains an Asset/Liability Committee (the "ALCO"), consisting of the Chief Executive Officer, the Chief Financial Officer, Chief Operating Officer, Chief Lending Officer, Chief Retail Officer, Chief Credit Officer, Chief Risk Officer and certain other senior officers. This committee meets quarterly to review the Company's financial results and to develop strategies to implement the Asset/Liability Policy and to respond to market conditions.

The Company monitors and controls interest rate risk through a variety of techniques, including use of an interest rate risk management model. With the interest rate risk management model, the Company projects future net interest income, and then estimates the effect of various changes in interest rates and balance sheet growth rates on that projected net interest income. The Company also uses the interest rate risk management model to calculate the change in net portfolio value over a range of interest rate change scenarios.

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Interest rate sensitivity modeling is done at a specific point in time and involves a variety of significant estimates and assumptions. Interest rate sensitivity modeling requires, among other things, estimates of how much and when yields and costs on individual categories of interest-earning assets and interest-bearing liabilities will respond to general changes in market rates, future cash flows and discount rates.

Net interest income simulation considers the relative sensitivities of the balance sheet including the effects of interest rate caps on adjustable rate mortgages and the relatively stable aspects of core deposits. As such, net interest income simulation is designed to address the probability of interest rate changes and the behavioral response of the balance sheet to those changes. Market Value of Portfolio Equity represents the fair value of the net present value of assets, liabilities and off-balance-sheet items. Changes in estimates and assumptions made for interest rate sensitivity modeling could have a significant impact on projected results and conclusions. These assumptions could include prepayment rates, sensitivity of non-maturity deposits, decay rates and other similar assumptions. Therefore, if our assumptions should change, this technique may not accurately reflect the impact of general interest rate movements on the Company's net interest income or net portfolio value.

Management reviews the accuracy of its model by back testing its results (comparing predicted results in past models with current data), and it periodically reviews its prepayment assumptions, decay rates and other assumptions.

The starting point (or "base case") for the following table is an estimate of the following year's net interest income assuming that both interest rates and the Company's interest-sensitive assets and liabilities remain at year-end levels. The net interest income estimated for 2019 (the base case) is $179.1 million. The information provided for net interest income assumes that changes in interest rates change gradually in equal increments ("rate ramp") over the twelve month period.

	Changes in Interest Rates	
Rate Ramp	+200 bp	-200 bp
Asset/Liability Policy limit	(5.0)%	(5.0)%
December 31, 2018	(1.5)%	(0.7)%
December 31, 2017	(1.1)%	(3.6)%

The ALCO's policy review of interest rate risk includes policy limits for net interest income changes in various "rate shock" scenarios. Rate shocks assume that current interest rates change immediately. The information provided for net interest income assumes fluctuations or "rate shocks" for changes in interest rates as shown in the table below.

	Changes in Interest Rates				
Rate Shock	+300 bp	+200 bp	+100 bp	-100 bp	-200 bp
Asset/Liability Policy limit	(15.0)%	(10.0)%	(5.0)%	(5.0)%	(10.0)%
December 31, 2018	0.6%	0.4%	0.3%	(2.5)%	(8.0)%
December 31, 2017	0.3%	0.3%	0.3%	(5.9)%	(10.3)%

The base case for the following table is an estimate of the Company's net portfolio value for the periods presented using current discount rates, and assuming the Company's interest-sensitive assets and liabilities remain at year-end levels. The net portfolio value at December 31, 2018 (the base case) was $849.7 million. The information provided for the net portfolio value assumes fluctuations or rate shocks for changes in interest rates as shown in the table below.

	Changes in Interest Rates				
Rate Shock	+300 bp	+200 bp	+100 bp	-100 bp	-200 bp
Asset/Liability Policy limit	(25.0)%	(20.0)%	(10.0)%	(10.0)%	(20.0)%
December 31, 2018	(5.2)%	(3.3)%	(1.4)%	(0.2)%	(1.5)%
December 31, 2017	(5.0)%	(3.3)%	(1.4)%	(0.4)%	(2.6)%

The information set forth above is based on significant estimates and assumptions, and constitutes a forward-looking statement under the Private Securities Litigation Reform Act of 1995.

The information in the above tables represent the policy scenario that the ALCO reviews on a quarterly basis. There are also other scenarios run that the ALCO examines that vary depending on the economic environment. These scenarios include a yield curve flattening scenario and scenarios that show more dramatic changes in rates. The committee uses alternative scenarios, depending on the economic environment, in its interest rate management decisions.

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Certain shortcomings are inherent in the methodologies used in the above interest rate risk measurements. Modeling changes in net interest income requires the making of certain assumptions regarding prepayment and deposit decay rates, which may or may not reflect the manner in which actual yields and costs respond to changes in market interest rates. While management believes such assumptions are reasonable, there can be no assurance that assumed prepayment rates and decay rates will approximate actual future loan prepayment and deposit withdrawal activity. Moreover, the net interest income table presented assumes that the composition of interest sensitive assets and liabilities existing at the beginning of a period remains constant over the period being measured and also assumes that a particular change in interest rates is reflected uniformly across the yield curve regardless of the duration to maturity or repricing of specific assets and liabilities. Accordingly, although the net interest income table provides an indication of the Company’s interest rate risk exposure at a particular point in time, such measurement is not intended to and does not provide a precise forecast of the effect of changes in market interest rates on net interest income and will differ from actual results.

Effects of Inflation

The impact of inflation, as it affects banks, differs substantially from the impact on non-financial institutions. Banks have assets which are primarily monetary in nature and which tend to move with inflation. This is especially true for banks with a high percentage of rate sensitive interest-earning assets and interest-bearing liabilities. A bank can further reduce the impact of inflation with proper management of its rate sensitivity gap. This gap represents the difference between interest rate sensitive assets and interest rate sensitive liabilities. Lakeland attempts to structure its assets and liabilities and manages its gap to protect against substantial changes in interest rate scenarios, in order to minimize the potential effects of inflation.

Capital Resources

Stockholders’ equity increased from $583.1 million on December 31, 2017 to $623.7 million on December 31, 2018. The increase in stockholders’ equity from December 31, 2017 to December 31, 2018 was primarily due to $63.4 million of net income, partially offset by the payment of cash dividends on common stock of $21.3 million.

Book value per common share (total common stockholders’ equity divided by the number of shares outstanding) increased from $12.31 on December 31, 2017 to $13.14 on December 31, 2018, primarily as a result of net income. Book value per common share was $11.65 on December 31, 2016. Tangible book value per share increased from $9.38 on December 31, 2017 to $10.22 on December 31, 2018. For more information see “Non-GAAP Financial Measures.”

The Company and Lakeland are subject to various regulatory capital requirements that are monitored by federal and state banking agencies. Failure to meet minimum capital requirements can lead to certain supervisory actions by regulators; any supervisory action could have a direct material adverse effect on the Company or Lakeland’s financial statements. As of December 31, 2018, the Company and Lakeland met all capital adequacy requirements to which they are subject.

The final rules implementing the Basel Committee on Banking Supervision’s (“BCBS”) capital guidelines for U.S. banks became effective for the Company on January 1, 2015, with full compliance with all of the final rule’s requirements phased in over a multi-year schedule, to be fully phased-in by January 1, 2019. As of December 31, 2018, the Company’s capital levels remained characterized as “well-capitalized” under the new rules.

On September 30, 2016, the Company completed an offering of $75.0 million fixed to floating rate subordinated notes due September 30, 2026. The notes bear interest at a rate of 5.125% per annum until September 30, 2021 and will then reset quarterly to the then current three-month LIBOR rate plus 397 basis points until maturity in September 2026 or their earlier redemption. The debt is included in Tier 2 capital for the Company. On September 30, 2016, the Company contributed $69.9 million to Lakeland’s capital, increasing the Bank’s capital ratios.

On December 14, 2016, the Company successfully completed an at-the-market common stock issuance. A total of 2,739,650 shares of the Company’s common stock were sold at a weighted average price of $18.25, representing gross proceeds to the Company of approximately $50.0 million. Net proceeds from the transaction, after the sales commission and other expenses, were approximately $48.7 million. The Company contributed $48.5 million to Lakeland's capital, increasing the Bank's capital ratios.

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The following table reflects capital ratios of the Company and Lakeland as of December 31, 2018 and 2017:

Capital Ratios	Tier 1 Capital to Total Average Assets Ratio December 31, 2018	2017	Common Equity Tier 1 to Risk-Weighted Assets Ratio December 31, 2018	2017	Tier 1 Capital to Risk-Weighted Assets Ratio December 31, 2018	2017	Total Capital to Risk-Weighted Assets Ratio December 31, 2018	2017
Company	9.39 %	9.12 %	10.62 %	10.18 %	11.27 %	10.87 %	13.71 %	13.40 %
Lakeland	10.17 %	10.06 %	12.20 %	12.00 %	12.20 %	12.00 %	13.06 %	12.86 %
Required capital ratios including conservation buffer	4.00 %	4.00 %	6.375 %	5.75 %	7.875 %	7.25 %	9.875 %	9.25 %
“Well capitalized” institution under FDIC regulations	5.00 %	5.00 %	6.50 %	6.50 %	8.00 %	8.00 %	10.00 %	10.00 %

Non-GAAP Financial Measures

Calculation of Tangible Book Value Per Common Share	December 31, 2018	2017	2016	2015	2014
	(dollars in thousands)				
Total common stockholders’ equity at end of period - GAAP	$623,739	$583,122	$550,044	$400,516	$379,438
Less:					
Goodwill	136,433	136,433	135,747	109,974	109,974
Other identifiable intangible assets, net	1,768	2,362	3,344	1,545	1,960
Total tangible common stockholders’ equity at end of period - Non-GAAP	$485,538	$444,327	$410,953	$288,997	$267,504
Shares outstanding at end of period (1)	47,486	47,354	47,223	37,906	37,911
Book value per share - GAAP (1)	$13.14	$12.31	$11.65	$10.57	$10.01
Tangible book value per share - Non-GAAP (1)	$10.22	$9.38	$8.70	$7.62	$7.06

(1) Adjusted for 5% stock dividends in 2014.

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Calculation of Tangible Common Equity to Tangible Assets	December 31, 2018	2017	2016	2015	2014
	(dollars in thousands)				
Total tangible common stockholders' equity at end of period - Non-GAAP	$485,538	$444,327	$410,953	$288,997	$267,504
Total assets at end of period - GAAP	$5,806,093	$5,405,639	$5,093,131	$3,869,550	$3,538,325
Less:					
Goodwill	136,433	136,433	135,747	109,974	109,974
Other identifiable intangible assets, net	1,768	2,362	3,344	1,545	1,960
Total tangible assets at end of period - Non-GAAP	$5,667,892	$5,266,844	$4,954,040	$3,758,031	$3,426,391
Common equity to assets - GAAP	10.74 %	10.79 %	10.80 %	10.35 %	10.72 %
Tangible common equity to tangible assets - Non-GAAP	8.57 %	8.44 %	8.30 %	7.69 %	7.81 %

Calculation of Return on Average Tangible Common Equity	For the Years Ended December 31, 2018	2017	2016	2015	2014
	(dollars in thousands)				
Net income - GAAP	$63,401	$52,580	$41,518	$32,481	$31,129
Total average common stockholders' equity - GAAP	$598,527	$568,680	$474,540	$392,221	$367,210
Less:					
Average goodwill	136,433	136,095	130,689	109,974	109,974
Average other identifiable intangible assets, net	2,064	2,847	3,225	1,759	2,200
Total average tangible common stockholders' equity - Non-GAAP	$460,030	$429,738	$340,626	$280,488	$255,036
Return on average common stockholders' equity - GAAP	10.59 %	9.25 %	8.75 %	8.28 %	8.48 %
Return on average tangible common stockholders' equity - Non-GAAP	13.78 %	12.24 %	12.19 %	11.58 %	12.21 %

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Quarterly Financial Data

The following represents summarized quarterly financial data of the Company, which in the opinion of management reflected all adjustments, consisting only of non-recurring adjustments, necessary for a fair presentation of the Company's results of operations.

	Quarter Ended			
	March 31, 2018	June 30, 2018	September 30, 2018	December 31, 2018
	(in thousands, except per share amounts)			
Total interest income	$50,145	$52,260	$ 54,282	$ 56,434
Total interest expense	7,909	8,767	10,658	12,228
Net interest income	42,236	43,493	43,624	44,206
Provision for loan and lease losses	1,284	1,492	1,046	591
Noninterest income (excluding investment securities gains)	5,334	5,709	5,639	5,628
Merger related expenses	—	—	—	464
Core deposit intangible amortization	157	153	142	142
Noninterest expense	26,980	27,421	27,651	28,057
Income before taxes	19,149	20,136	20,424	20,580
Income taxes	3,894	4,298	3,666	5,030
Net income	$15,255	$15,838	$ 16,758	$ 15,550
Earnings per share of common stock				
Basic	$0.32	$0.33	$ 0.35	$ 0.32
Diluted	$0.32	$0.33	$ 0.35	$ 0.32

	Quarter Ended			
	March 31, 2017	June 30, 2017	September 30, 2017	December 31, 2017
	(in thousands, except per share amounts)			
Total interest income	$44,796	$47,212	$ 48,735	$ 49,461
Total interest expense	5,473	5,791	6,620	7,082
Net interest income	39,323	41,421	42,115	42,379
Provision for loan and lease losses	1,218	1,827	1,827	1,218
Noninterest income (excluding investment securities gains)	5,555	6,126	5,454	5,776
Gains on investment securities, net	2,539	(15)	—	—
Long-term debt prepayment fee	2,828	—	—	—
Core deposit intangible amortization	195	190	104	165
Noninterest expense	25,447	25,176	24,745	25,684
Income before taxes	17,729	20,339	20,893	21,088
Income taxes	5,417	6,969	7,170	7,913
Net income	$12,312	$13,370	$ 13,723	$ 13,175
Earnings per share of common stock				
Basic	$0.26	$0.28	$ 0.29	$ 0.28
Diluted	$0.26	$0.28	$ 0.29	$ 0.27

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Item 7A - Quantitative and Qualitative Disclosures About Market Risk.

See Item 7 - “Management’s Discussion and Analysis of Financial Condition and Results of Operations.”

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Item 8 - Financial Statements and Supplementary Data.

Report of Independent Registered Public Accounting Firm
To the Stockholders and Board of Directors
Lakeland Bancorp, Inc.:

Opinion on the Consolidated Financial Statements

We have audited the accompanying consolidated balance sheets of Lakeland Bancorp, Inc. and subsidiaries (the Company) as of December 31, 2018 and 2017, the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for each of the years in the three year period ended December 31, 2018, and the related notes (collectively, the consolidated financial statements). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2018 and 2017, and the results of its operations and its cash flows for each of the years in the three year period ended December 31, 2018, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company's internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated March 1, 2019 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

Basis for Opinion

These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ KPMG LLP

We have served as the Company's auditor since 2013.
Short Hills, New Jersey
March 1, 2019

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Lakeland Bancorp, Inc. and Subsidiaries
CONSOLIDATED BALANCE SHEETS

	December 31,	
	2018	2017
	(dollars in thousands)	
ASSETS		
Cash	$205,199	$114,138
Interest-bearing deposits due from banks	3,400	28,795
Total cash and cash equivalents	208,599	142,933
Investment securities, available for sale, at fair value	638,618	628,046
Equity securities, at fair value	15,921	18,089
Investment securities, held to maturity, at amortized cost with fair value of $150,932 at December 31, 2018 and $138,688 at December 31, 2017	153,646	139,685
Federal Home Loan Bank and other membership stock, at cost	13,301	12,576
Loans and leases, net of deferred fees	4,456,733	4,152,720
Less: allowance for loan and lease losses	37,688	35,455
Net loans	4,419,045	4,117,265
Loans held for sale	1,113	456
Premises and equipment, net	49,175	50,313
Accrued interest receivable	16,114	14,416
Goodwill	136,433	136,433
Other identifiable intangible assets	1,768	2,362
Bank owned life insurance	110,052	107,489
Other assets	42,308	35,576
TOTAL ASSETS	$5,806,093	$5,405,639
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES:		
Deposits:		
Noninterest-bearing	$950,218	$967,335
Savings and interest-bearing transaction accounts	2,913,414	2,663,985
Time deposits $250 thousand and under	589,737	556,863
Time deposits over $250 thousand	167,301	180,565
Total deposits	4,620,670	4,368,748
Federal funds purchased and securities sold under agreements to repurchase	233,905	124,936
Other borrowings	181,118	192,011
Subordinated debentures	105,027	104,902
Other liabilities	41,634	31,920
TOTAL LIABILITIES	5,182,354	4,822,517
STOCKHOLDERS' EQUITY:		
Common stock, no par value; authorized 100,000,000 shares; issued shares, 47,486,250 at December 31, 2018 and authorized 70,000,000 shares; issued shares 47,353,864 at December 31, 2017	514,703	512,734
Retained earnings	116,874	72,737
Accumulated other comprehensive loss	(7,838)	(2,349)
TOTAL STOCKHOLDERS' EQUITY	623,739	583,122
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$5,806,093	$5,405,639

The accompanying notes are an integral part of these statements.

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Lakeland Bancorp, Inc. and Subsidiaries
CONSOLIDATED STATEMENTS OF INCOME

	Years Ended December 31,		
	2018	2017	2016
	(in thousands, except per share data)		
INTEREST INCOME			
Loans, leases and fees	$193,143	$172,342	$149,777
Federal funds sold and interest-bearing deposits with banks	1,559	880	569
Taxable investment securities and other	16,710	14,987	11,163
Tax-exempt investment securities	1,709	1,995	1,787
TOTAL INTEREST INCOME	213,121	190,204	163,296
INTEREST EXPENSE			
Deposits	30,620	16,600	10,512
Federal funds purchased and securities sold under agreements to repurchase	471	198	69
Other borrowings	8,471	8,168	7,066
TOTAL INTEREST EXPENSE	39,562	24,966	17,647
NET INTEREST INCOME	173,559	165,238	145,649
Provision for loan and lease losses	4,413	6,090	4,223
NET INTEREST INCOME AFTER PROVISION FOR LOAN AND LEASE LOSSES	169,146	159,148	141,426
NONINTEREST INCOME			
Service charges on deposit accounts	10,584	10,740	10,157
Commissions and fees	5,542	4,858	4,349
Income on bank owned life insurance	3,256	2,354	2,562
Loss on equity securities	(583)	—	—
Gains on sales of loans	1,329	1,836	2,123
Gain on sales and calls of investment securities, net	—	2,524	370
Other income	2,182	3,123	1,769
TOTAL NONINTEREST INCOME	22,310	25,435	21,330
NONINTEREST EXPENSE			
Salaries and employee benefits	68,595	61,166	56,107
Net occupancy expense	10,155	10,243	9,935
Furniture and equipment	8,297	8,269	8,017
FDIC insurance expense	1,608	1,577	2,248
Stationery, supplies and postage	1,625	1,797	1,727
Marketing expense	1,437	1,675	1,672
Data processing expense	3,609	1,993	1,891
Telecommunications expense	1,769	1,607	1,631
ATM and debit card expense	2,195	2,051	1,582
Core deposit intangible amortization	594	654	734
Other real estate and repossessed asset expense	158	181	116
Long-term debt prepayment fee	—	2,828	—
Merger related expenses	464	—	4,103
Other expenses	10,661	10,493	10,154
TOTAL NONINTEREST EXPENSE	111,167	104,534	99,917
Income before provision for income taxes	80,289	80,049	62,839
Provision for income taxes	16,888	27,469	21,321

NET INCOME	$63,401	$52,580	$41,518
PER SHARE OF COMMON STOCK:			
Basic earnings	$1.32	$1.10	$0.96
Diluted earnings	$1.32	$1.09	$0.95
Cash dividends	$0.45	$0.40	$0.37

The accompanying notes are an integral part of these statements.

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Lakeland Bancorp, Inc. and Subsidiaries
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	For the Years Ended December 31,		
	2018	2017	2016
	(in thousands)		
NET INCOME	$63,401	$52,580	$41,518
OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAX:			
Unrealized losses on securities available for sale	(3,507)	(903)	(1,038)
Reclassification for securities gains included in net income	—	(1,640)	(233)
Unrealized gains on derivatives	41	37	672
Change in pension liability, net	20	(16)	42
Other comprehensive loss	(3,446)	(2,522)	(557)
TOTAL COMPREHENSIVE INCOME	$59,955	$50,058	$40,961

The accompanying notes are an integral part of these statements.

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Lakeland Bancorp, Inc. and Subsidiaries
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
For the Years Ended December 31, 2018, 2017 and 2016

	Common Stock	Retained Earnings (Accumulated Deficit)	Accumulated Other Comprehensive Income (Loss)	Total
	(in thousands)			
At January 1, 2016	$386,287	$ 13,079	$ 1,150	$400,516
Net income	—	41,518	—	41,518
Other comprehensive loss, net of tax	—	—	(557)	(557)
Stock based compensation	1,899	—	—	1,899
Issuance of stock for Pascack acquisition	37,221	—	—	37,221
Issuance of stock for Harmony acquisition	36,654	—	—	36,654
Issuance of stock	48,678	—	—	48,678
Retirement of restricted stock	(206)	—	—	(206)
Exercise of stock options, net of excess tax benefits	328	—	—	328
Cash dividends, common stock	—	(16,007)	—	(16,007)
At December 31, 2016	$510,861	$ 38,590	$ 593	$550,044
Net income	—	52,580	—	52,580
Other comprehensive loss, net of tax	—	—	(2,522)	(2,522)
Adjustment related to implementation of ASU 2018-02	—	420	(420)	—
Stock based compensation	2,325	—	—	2,325
Retirement of restricted stock	(773)	—	—	(773)
Exercise of stock options	321	—	—	321
Cash dividends, common stock	—	(18,853)	—	(18,853)
At December 31, 2017	$512,734	$ 72,737	$ (2,349)	$583,122
Cumulative adjustment for adoption of ASU 2016-01	—	2,043	(2,043)	—
January 1, 2018, as adjusted	512,734	74,780	(4,392)	583,122
Net income	—	63,401	—	63,401
Other comprehensive loss, net of tax	—	—	(3,446)	(3,446)
Stock based compensation	2,425	—	—	2,425
Retirement of restricted stock	(763)	—	—	(763)
Exercise of stock options	307	—	—	307
Cash dividends, common stock	—	(21,307)	—	(21,307)
At December 31, 2018	$514,703	$ 116,874	$ (7,838)	$623,739

The accompanying notes are an integral part of these statements.

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Lakeland Bancorp, Inc. and Subsidiaries
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended December 31,		
	2018	2017	2016
	(in thousands)		
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	$63,401	$52,580	$41,518
Adjustments to reconcile net income to net cash provided by operating activities:			
Net amortization of premiums, discounts and deferred loan fees and costs	4,153	5,153	4,581
Depreciation and amortization	5,555	4,536	3,961
Amortization of intangible assets	594	654	734
Provision for loan and lease losses	4,413	6,090	4,223
Stock based compensation	2,425	2,325	1,899
Loans originated for sale	(49,748)	(60,783)	(85,365)
Proceeds from sales of loans held for sale	50,420	63,905	86,859
Gains on sales of securities	—	(2,524)	(370)
Gains on sales of loans held for sale	(1,329)	(1,836)	(2,003)
Gains on proceeds from bank owned life insurance policies	(421)	(109)	(864)
Change in market value of equity securities	583	—	—
Gains on other real estate and other repossessed assets	(338)	(646)	(248)
Loss (gain) on sale of premises and equipment	561	(838)	117
Long-term debt prepayment penalty	—	2,828	—
Deferred tax (benefit) expense	(13,571)	16,904	(987)
Excess tax benefits	318	587	—
Decrease (increase) in other assets	2,679	(25,065)	(5,600)
Increase in other liabilities	9,743	3,705	1,618
NET CASH PROVIDED BY OPERATING ACTIVITIES	79,438	67,466	50,073
CASH FLOWS FROM INVESTING ACTIVITIES:			
Net cash acquired in acquisitions	—	—	68,751
Proceeds from repayments and maturities of available for sale securities	91,833	91,314	79,425
Proceeds from repayments and maturities of held to maturity securities	26,083	43,218	28,421
Proceeds from sales of equity securities	2,155	—	—
Proceeds from sales of available for sale securities	—	4,500	15,654
Purchase of available for sale securities	(110,370)	(140,258)	(244,861)
Purchase of held to maturity securities	(40,753)	(35,841)	(59,715)
Purchase of equity securities	(570)	(307)	(838)
Proceeds from redemptions of Federal Home Loan Bank stock	6,799	13,497	3,054
Purchases of Federal Home Loan Bank stock	(7,524)	(10,974)	(323)
Purchase of bank owned life insurance	—	(33,000)	—
Death benefit proceeds from bank owned life insurance policy	755	312	2,129
Net increase in loans and leases	(310,256)	(289,914)	(334,040)
Proceeds from dispositions and sales of bank premises and equipment	697	1,638	21
Purchases of premises and equipment	(5,523)	(3,972)	(3,977)
Proceeds from sales of other real estate and other repossessed assets	4,116	4,638	3,545
NET CASH USED IN INVESTING ACTIVITIES	(342,558)	(355,149)	(442,754)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Net increase in deposits	252,329	276,537	515,437
	108,969	68,582	(94,880)

Increase (decrease) in federal funds purchased and securities sold under agreements to repurchase			
Proceeds from other borrowings	60,003	306,184	14,921
Repayments of other borrowings	(70,752)	(377,183)	(91,798)
Net proceeds from issuance of subordinated debt	—	—	73,516
Exercise of stock options	307	321	285
Net proceeds from issuance of common stock	—	—	48,678
Retirement of restricted stock	(763)	(773)	(206)
Excess tax benefits	—	—	43
Dividends paid	(21,307)	(18,853)	(16,007)
NET CASH PROVIDED BY FINANCING ACTIVITIES	328,786	254,815	449,989
Net increase (decrease) in cash and cash equivalents	65,666	(32,868)	57,308
Cash and cash equivalents, beginning of year	142,933	175,801	118,493
CASH AND CASH EQUIVALENTS, END OF YEAR	$208,599	$142,933	$175,801

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Lakeland Bancorp, Inc. and Subsidiaries
CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)

	Years Ended December 31,		
	2018	2017	2016
	(in thousands)		
Supplemental schedule of non-cash investing and financing activities:			
Cash paid during the period for income taxes	$18,614	$27,423	$21,744
Cash paid during the period for interest	38,679	24,571	16,435
Transfer of loans and leases into other repossessed assets and other real estate owned	3,765	3,763	3,386
Acquisitions of Pascack and Harmony:			
Non-cash assets acquired:			
Federal Home Loan Bank stock	—	—	3,742
Investment securities held for maturity	—	—	10,810
Investment securities available for sale	—	—	7,474
Loans, including loans held for sale	—	—	579,560
Goodwill and other intangible assets, net	—	—	29,060
Other assets	—	—	32,381
Total non-cash assets acquired	—	—	663,027
Liabilities assumed:			
Deposits	—	—	(582,526)
Other borrowings	—	—	(66,622)
Other liabilities	—	—	(8,755)
Total liabilities assumed	—	—	(657,903)
Common stock issued for acquisitions	—	—	73,875

The accompanying notes are an integral part of these statements.

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Lakeland Bancorp, Inc. and Subsidiaries
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
NOTE 1 - SUMMARY OF ACCOUNTING POLICIES

Lakeland Bancorp, Inc. (the "Company") is a bank holding company whose principal activity is the ownership and management of its wholly owned subsidiary, Lakeland Bank ("Lakeland"). Lakeland operates under a state bank charter and provides full banking services and, as a state bank, is subject to regulation by the New Jersey Department of Banking and Insurance. Lakeland generates commercial, mortgage and consumer loans and receives deposits from customers located primarily in Northern and Central New Jersey. Through a third party, Lakeland also provides non-deposit products, such as securities brokerage services including mutual funds and variable annuities.

Lakeland operates as a commercial bank offering a wide variety of commercial loans and leases and, to a lesser degree, consumer credits. Its primary strategic aim is to establish a reputation and market presence as the "small and middle market business bank" in its principal markets. Lakeland funds its loans primarily by offering demand deposit, savings and money market, and time deposit accounts to both commercial enterprises and individuals. Additionally, it originates residential mortgage loans, and services such loans which are owned by other investors. Lakeland also has an equipment finance division which provides loans to finance equipment primarily to small and medium sized business clients (referred to as "Leases") and an asset based lending department which specializes in utilizing particular assets to fund the working capital needs of borrowers.

The Company and Lakeland are subject to regulations of certain state and federal agencies and, accordingly, are periodically examined by those regulatory authorities. As a consequence of the extensive regulation of commercial banking activities, Lakeland's business is particularly susceptible to being affected by state and federal legislation and regulations.

Basis of Financial Statement Presentation

The accounting and reporting policies of the Company and its subsidiaries conform with accounting principles generally accepted in the United States of America ("U.S. GAAP") and predominant practices within the banking industry. The consolidated financial statements include the accounts of the Company, Lakeland, Lakeland NJ Investment Corp., Lakeland Investment Corp., Lakeland Equity, Inc. and Lakeland Preferred Equity, Inc. All significant intercompany balances and transactions have been eliminated in consolidation. Certain reclassifications have been made in the consolidated financial statements to conform with current year classifications.

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. These estimates and assumptions also affect reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates. The principal estimates that are particularly susceptible to significant change in the near term relate to the allowance for loan and lease losses and the valuation of the Company's investment securities portfolio. The policies regarding these estimates are discussed below.

The Company's operating segments are components of its enterprise for which separate financial information is available and is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and assess performance. The Company's chief operating decision maker is its Chief Executive Officer. All of the Company's financial services activities are interrelated, and each activity is dependent and assessed based on how each of the activities of the Company supports the others. For example, commercial lending is dependent upon the ability of Lakeland to fund itself with retail deposits and other borrowings and to manage interest rate and credit risk. The situation is also similar for consumer and residential mortgage lending. Moreover, the Company primarily operates in one market area, Northern and Central New Jersey and contiguous areas. Therefore, all significant operating decisions are based upon analysis of the Company as one operating segment or unit. Accordingly, the Company has determined that it has one operating segment and thus one reporting segment.

Cash and Cash Equivalents

Cash and cash equivalents are defined as cash on hand, cash items in the process of collection, amounts due from banks and federal funds sold with an original maturity of three months or less. A portion of Lakeland's cash on hand and on deposit with the Federal Reserve Bank was required to meet regulatory reserve and clearing requirements.

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Investment Securities

Investment securities are classified as held to maturity or available for sale. Management determines the appropriate classification of investment securities at the time of purchase. Investments in securities, for which management has both the ability and intent to hold to maturity, are classified as held to maturity and carried at cost, adjusted for the amortization of premiums and accretion of discounts computed by the effective interest method. Investments in debt securities, which management believes may be sold prior to maturity due to changes in interest rates, prepayment risk, liquidity requirements, or other factors, are classified as available for sale. Net unrealized gains and losses for such securities, net of tax effect, are reported as other comprehensive income (loss) and excluded from the determination of net income. Gains or losses on disposition of investment securities are based on the net proceeds and the adjusted carrying amount of the securities sold using the specific identification method. Losses are recorded through the statement of income when the impairment is considered other-than-temporary, even if a decision to sell has not been made.

The Company evaluates its investment securities portfolio for impairment each quarter. In estimating other-than-temporary losses, the Company considers the length of time and the extent to which the fair value has been less than cost, the financial condition and near-term prospects of the issuer, and whether the Company is more likely than not to sell the security before recovery of its cost basis. If a security has been impaired for more than twelve months, and the impairment is deemed other-than-temporary, a write down will occur in that quarter. If a loss is deemed to be other-than-temporary, it is recognized as a realized loss in the income statement with the security assigned a new cost basis.

If the Company intends to sell an impaired security, the Company records an other-than-temporary loss in an amount equal to the entire difference between the fair value and amortized cost. If a security is determined to be other-than-temporarily impaired, but the Company does not intend to sell the security, only the credit portion of the estimated loss is recognized in earnings in gain (loss) on securities, with the other portion of the loss recognized in other comprehensive income. If a determination is made that an equity security is other-than-temporarily impaired, the unrealized loss will be recognized as an other-than-temporary impairment charge in noninterest income as a component of gain (loss) on investment securities.

The Company has an equity securities portfolio, which consists of investments in other financial institutions for market appreciation purposes, and recognizes net unrealized gains and losses through net income.

Loans and Leases and Allowance for Loan and Lease Losses

Loans and leases that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are stated at the amount of unpaid principal and are net of unearned discount, unearned loan fees and an allowance for loan and lease losses.

Interest income is accrued as earned on a simple interest basis, adjusted for prepayments. All unamortized fees and costs related to the loan are amortized over the life of the loan using the interest method. Accrual of interest is discontinued on a loan or lease when management believes, after considering economic and business conditions and collection efforts, that the borrower’s financial condition is such that full collection of interest and principal is doubtful. When a loan or lease is placed on such non-accrual status, all accumulated accrued interest receivable is reversed out of current period income.

Commercial loans and leases are placed on a non-accrual status with all accrued interest and unpaid interest reversed if (a) because of the deterioration in the financial position of the borrowers they are maintained on a cash basis (which means payments are applied when and as received rather than on a regularly scheduled basis), (b) payment in full of interest or principal is not expected, or (c) principal and interest have been in default for a period of 90 days or more unless the obligation is both well-secured and in process of collection. Residential mortgage loans and closed-end consumer loans are placed on non-accrual status at the time principal and interest have been in default for a period of 90 days or more, except where there exists sufficient collateral to cover the defaulted principal and interest payments, and the loans are well-secured and in the process of collection. Open-end consumer loans secured by real estate are generally placed on non-accrual and reviewed for charge-off when principal and interest payments are four months in arrears unless the obligations are well-secured and in the process of collection. Interest thereafter on such charged-off loans is taken into income when received only after full recovery of principal. As a general rule, a non-accrual asset may be restored to accrual status when none of its principal or interest is due and unpaid, satisfactory payments have been received for a sustained period (usually six months), or when it otherwise becomes well-secured and in the process of collection.

The Company defines impaired loans as all non-accrual loans with recorded investments of $500,000 or greater. Impaired loans also include all loans modified as troubled debt restructurings. Loans and leases are considered impaired when, based on current information and events, it is probable that Lakeland will be unable to collect all amounts due in accordance with the original contractual terms of the loan agreement, including scheduled principal and interest payments.

Impairment is measured based on the present value of expected cash flows discounted at the loan's effective interest rate, or as a practical expedient, Lakeland may measure impairment based on a loan's observable market price, or the fair value of the collateral, less estimated costs to sell, if the loan is collateral-dependent. Regardless of the measurement method, Lakeland measures impairment based on the fair value of the collateral when it is determined that foreclosure is probable. Most of Lakeland's impaired loans are collateral-dependent. Shortfalls in collateral or cash flows are charged-off or specifically reserved for in the period the short-fall is identified. Charge-offs are recommended by the Chief Credit Officer and approved by the Board.

Lakeland groups impaired commercial loans under $500,000 into homogeneous pools and collectively evaluates them. Interest received on impaired loans and leases may be recorded as interest income. However, if management is not reasonably certain that an impaired loan and lease will be repaid in full, or if a specific time frame to resolve full collection cannot yet be reasonably determined, all payments received are recorded as reductions of principal.

Purchased Credit-Impaired ("PCI") loans are loans acquired through acquisition or purchased at a discount that is due, in part, to credit quality. PCI loans are accounted for in accordance with ASC Subtopic 310-30 and are initially recorded at fair value (as determined by the present value of expected future cash flows) with no valuation allowance (i.e., the allowance for loan losses). The difference between the undiscounted cash flows expected at acquisition and the initial carrying amount (fair value) of the covered loans, or the "accretable yield," is recognized as interest income utilizing the level-yield method over the life of the loans. Contractually required payments for interest and principal that exceed the undiscounted cash flows expected at acquisition, or the "non-accretable difference," are not recognized as a yield adjustment, as a loss accrual or a valuation allowance. Reclassifications of the non-accretable difference to the accretable yield may occur subsequent to the loan acquisition dates due to increases in expected cash flows of the loans and results in an increase in yield on a prospective basis. Subsequent to acquisition date, further credit deterioration of a PCI loan will result in a valuation allowance recognized in the allowance for loan and lease losses.

Loans are classified as troubled debt restructured loans ("TDRs") in cases where borrowers experience financial difficulties and Lakeland makes certain concessionary modifications to contractual terms. Restructured loans typically involve a modification of terms such as a reduction of the stated interest rate, an extended moratorium of principal payments and/or an extension of the maturity date at a stated interest rate lower than the current market rate for a new loan with similar risk. Nonetheless, restructured loans are classified as impaired loans.

If a loan has been restructured, it will continue to be classified as a TDR until it is fully repaid or until it meets all of the following criteria: 1) the borrower is no longer experiencing financial difficulties, 2) the rate is not less than the rate provided for similar credit risk, 3) other terms are no less favorable than similar new debt and 4) no concessions were granted.

The allowance for loan and lease losses is the estimated amount considered necessary to cover probable and reasonably estimable incurred losses inherent in the loan portfolio at the balance sheet date. In determining the allowance, we make significant estimates and judgments, and, therefore, have identified the allowance as a critical accounting policy. The allowance is established through a provision for loan and lease losses charged against income. Loan principal considered to be uncollectible by management is charged against the allowance.

The allowance for loan and lease losses has been determined in accordance with U.S. GAAP. We are responsible for the timely and periodic determination of the amount of the allowance required. We believe that our allowance is adequate to cover identifiable losses, as well as estimated losses inherent in our portfolio for which certain losses are probable but not specifically identifiable.

The determination of the adequacy of the allowance for loan and lease losses and the periodic provisioning for estimated losses included in the consolidated financial statements is the responsibility of management and the Board of Directors. Management performs a formal quarterly evaluation of the allowance for loan and lease losses. This quarterly process is performed by the credit administration department and approved by the Chief Credit Officer. All supporting documentation with regard to the evaluation process is maintained by the credit administration department. Each quarter, the evaluation along with the supporting documentation is reviewed by the finance department before approval by the Chief Credit Officer. The allowance evaluation is then presented to an Allowance for Loan and Lease Losses committee, which gives final approval to the allowance evaluation before being presented to the Board of

Directors for their approval.

Additionally, the Company continually evaluates, through its governance process, the development of the allowance for loan and lease losses methodology. During the third quarter of 2017, the Company refined and enhanced its quantitative framework by implementing loss migration periods to determine historical loss rates. It also enhanced its qualitative framework to complement the loss migration historical loss rates. These enhancements were implemented to increase the level of precision in the allowance for loan and lease losses and did not result in a material change in the required allowance for loan and lease losses.

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The methodology employed for assessing the adequacy of the allowance consists of the following criteria:

- The establishment of specific reserve amounts for impaired loans and leases, including PCI loans.
- The establishment of reserves for pools of homogeneous loans and leases not subject to specific review, including impaired loans under $500,000, leases, 1 - 4 family residential mortgages, and consumer loans.

The establishment of reserve amounts for pools of homogeneous loans and leases are based upon the determination of historical loss rates, which are adjusted to reflect current conditions through the use of qualitative factors. The qualitative factors considered by the Company includes an evaluation of the results of the Company’s independent loan review function, the Company's reporting capabilities, the adequacy and expertise of Lakeland’s lending staff, underwriting policies, loss histories, trends in the portfolio, delinquency trends, economic and business conditions and capitalization rates. Since many of Lakeland’s loans depend on the sufficiency of collateral as a secondary source of repayment, any adverse trends in the real estate market could affect the underlying values available to protect Lakeland from losses.

Additionally, management determines the loss emergence periods for each loan segment, which are used to define loss migration periods and establish appropriate ranges for qualitative adjustments for each loan segment. The loss emergence period is the estimated time from the date of a loss event (such as a personal bankruptcy) to the actual recognition of the loss (typically via the first partial or full loan charge-off), and is determined based upon a study of our past loss experience by loan segment. All of the factors considered in the analysis of the adequacy of the allowance for loan and lease losses may be subject to change. To the extent actual outcomes differ from management estimates, additional provisions for loan and lease losses may be required that would adversely impact earnings in future periods.

A loan that management designates as impaired is reviewed for charge-off when it is placed on non-accrual status with a resulting charge-off if the loan is not secured by collateral having sufficient liquidation value to repay the loan if the loan is collateral dependent or charged off if deemed uncollectible. For a loan that is not collateral dependent, a reserve may be established for any shortfall in expected cash flows. Charge-offs are recommended by the Chief Credit Officer and approved by the Board.

Loans Held for Sale

Mortgage loans originated and intended for sale in the secondary market are carried at the lower of aggregate cost or estimated fair value. Gains and losses on sales of loans are specifically identified and accounted for in accordance with U.S. GAAP which requires that an entity engaged in mortgage banking activities classify the retained mortgage-backed security or other interest, which resulted from the securitization of a mortgage loan held for sale, based upon its ability and intent to sell or hold these investments.

Premises and Equipment, Net

Premises and equipment, including leasehold improvements, are stated at cost less accumulated depreciation. Depreciation expense is computed on the straight-line method over the estimated useful lives of the assets. Leasehold improvements are depreciated over the shorter of the estimated useful lives of the improvements or the terms of the related leases.

Other Real Estate Owned and Other Repossessed Assets

Other real estate owned (OREO) and other repossessed assets, representing property acquired through foreclosure (or deed-in-lieu-of-foreclosure), are carried at fair value less estimated disposal costs of the acquired property. Costs relating to holding the assets are charged to expense. An allowance for OREO or other repossessed assets is established, through charges to expense, to maintain properties at fair value less estimated costs to sell. Operating results of OREO and other repossessed assets, including rental income and operating expenses, are included in other expenses.

Mortgage Servicing

Lakeland performs various servicing functions on loans owned by others. A fee, usually based on a percentage of the outstanding principal balance of the loan, is received for these services. At December 31, 2018 and 2017, Lakeland was servicing approximately $19.9 million and $23.0 million, respectively, of loans for others.

Lakeland originates certain mortgages under a definitive plan to sell or securitize those loans and service the loans owned by the investor. Upon the transfer of the mortgage loans in a sale or a securitization, Lakeland records the servicing assets retained. Lakeland records mortgage servicing rights and the loans based on relative fair values at the date of origination and evaluates the mortgage servicing rights for impairment at each reporting period. Lakeland also originates loans that it sells to other banks and investors and does not retain the servicing rights.

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Mortgage Servicing Rights

When mortgage loans are sold with servicing retained, servicing rights are initially recorded at fair value with the income statement effect recorded in gains on sales of loans. Fair value is based on market prices for comparable mortgage servicing contracts, when available, or alternatively, is based on a valuation model that calculates the present value of estimated future net servicing income. All classes of servicing assets are subsequently measured using the amortization method which requires servicing rights to be amortized into noninterest income in proportion to, and over the period of, the estimated future net servicing income of the underlying loans. As of December 31, 2018 and 2017, Lakeland had originated mortgage servicing rights of $68,000 and $88,000, respectively.

Under the amortization measurement method, Lakeland subsequently measures servicing rights at fair value at each reporting date and records any impairment in value of servicing assets in earnings in the period in which the impairment occurs. The fair values of servicing rights are subject to fluctuations as a result of changes in estimated and actual prepayment speeds and default rates and losses. Servicing fee income, which is reported on the income statement as commissions and fees, is recorded for fees earned for servicing loans. The fees are based on a contractual percentage of the outstanding principal or a fixed amount per loan, and are recorded as income when earned.

Transfers of Financial Assets

Transfers of financial assets are accounted for as sales, when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (1) the assets have been isolated from the Company, put presumptively beyond the reach of the transferor and its creditors even in bankruptcy or other receivership, (2) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets and (3) the Company does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity or the ability to unilaterally cause the holder to return specific assets.

Derivatives

Lakeland enters into interest rate swaps (“swaps”) with loan customers to provide a facility to mitigate the fluctuations in the variable rate on the respective loans. These swaps are matched in offsetting terms to swaps that Lakeland enters into with an outside third party. The swaps are reported at fair value in other assets or other liabilities. Lakeland’s swaps qualify as derivatives, but are not designated as hedging instruments, thus any net gain or loss resulting from changes in the fair value is recognized in other noninterest income.

The credit risk associated with derivatives executed with customers is similar as that involved in extending loans and is subject to normal credit policies. Collateral is obtained based on management’s assessment of the customer. The positions of customer derivatives are recorded at fair value and changes in value are included in noninterest income on the consolidated statement of income.

Cash flow hedges are used primarily to minimize the variability in cash flows of assets or liabilities, or forecasted transactions caused by interest rate fluctuations. Changes in the fair value of derivatives designated as cash flow hedges are recorded in accumulated other comprehensive income and are reclassified into the line item in the income statement in which the hedged item is recorded in the same period the hedged item affects earnings. Hedge ineffectiveness and gains and losses on the component of a derivative excluded in assessing hedge effectiveness are recorded in the same income statement line item.

Further discussion of Lakeland’s financial derivatives is set forth in Note 19 to the Consolidated Financial Statements.

Earnings Per Share

Earnings per share is calculated on the basis of the weighted average number of common shares outstanding during the year. Basic earnings per share excludes dilution and is computed by dividing income available to common shareholders by the weighted average common shares outstanding during the period. Diluted earnings per share takes into account the potential dilution that could occur if securities or other contracts to issue common stock were exercised and converted into common stock.

Employee Benefit Plans

The Company has certain employee benefit plans covering substantially all employees. The Company accrues such costs as incurred.

We recognize the overfunded or underfunded status of pension and postretirement benefit plans in accordance with U.S. GAAP. Actuarial gains and losses, prior service costs or credits, and any remaining transition assets or obligations are recognized as a component of Accumulated Other Comprehensive Income, net of tax effects, until they are amortized as a component of net periodic benefit cost.

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Comprehensive Income (Loss)

The Company reports comprehensive income (loss) in addition to net income from operations. Other comprehensive income (loss) includes items recorded directly in equity such as unrealized gains or losses on securities available for sale as well as unrealized gains (losses) recorded on derivatives and benefit plans.

Goodwill and Other Identifiable Intangible Assets

Goodwill is presumed to have an indefinite useful life and is tested, at least annually, for impairment at the reporting unit level. Impairment exists when the carrying amount of goodwill exceeds its implied fair value. For purposes of our goodwill impairment testing, we have identified a single reporting unit, community banking.

U.S. GAAP permits an entity to make a qualitative assessment of whether it is more likely than not that a reporting unit’s fair value is less than its carrying amount before applying the two-step goodwill impairment test. The Company completed its annual qualitative assessment as of November 30, 2018 and concluded that there was less than a 50% probability that the fair value of the reporting unit is less than its carrying amount and, therefore, the two-step goodwill impairment test was not required.

Bank Owned Life Insurance

Lakeland invests in bank owned life insurance (“BOLI”). BOLI involves the purchasing of life insurance by Lakeland on a chosen group of employees. Lakeland is the owner and beneficiary of the policies. At December 31, 2018 and 2017, Lakeland had $110.1 million and $107.5 million, respectively, in BOLI. Income earned on BOLI was $3.3 million, $2.4 million and $2.6 million for the years ended December 31, 2018, 2017 and 2016, respectively. BOLI is accounted for using the cash surrender value method and is recorded at its net realizable value.

Income Taxes

The Company accounts for income taxes under the asset and liability method of accounting for income taxes. Deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities as measured by the enacted tax rates that will be in effect when these differences reverse. Deferred tax expense is the result of changes in deferred tax assets and liabilities. The principal types of differences between assets and liabilities for financial statement and tax return purposes are allowance for loan and lease losses, core deposit intangibles, deferred loan fees and deferred compensation.

Variable Interest Entities

Management has determined that Lakeland Bancorp Capital Trust II and Lakeland Bancorp Capital Trust IV (collectively, “the Trusts”) qualify as variable interest entities. The Trusts issued mandatorily redeemable preferred stock to investors and loaned the proceeds to the Company. The Trusts hold, as their sole asset, subordinated debentures issued by the Company. The Company is not considered the primary beneficiary of the Trusts, therefore the Trusts are not consolidated in the Company’s financial statements.

The Company’s maximum exposure to the Trusts is $30.0 million at December 31, 2018 which is the Company’s liability to the Trusts and includes the Company’s investment in the Trusts.

The Federal Reserve has issued guidance on the regulatory capital treatment for the trust preferred securities issued by the Trusts. The rule retains the current maximum percentage of total capital permitted for trust preferred securities at 25%, but enacts other changes to the rules governing trust preferred securities that affect their use as part of the collection of entities known as “restricted core capital elements.” The rule allows bank holding companies to continue to count trust preferred securities as Tier 1 Capital. The Company’s capital ratios continue to be categorized as “well-capitalized” under the regulatory framework for prompt corrective action. Under the Collins Amendment to the Dodd-Frank Wall Street Reform and Consumer Protection Act, any new issuance of trust preferred securities by the Company would not be eligible as regulatory capital.

New Accounting Pronouncements

In August 2018, the Financial Accounting Standards Board ("FASB") issued an update to improve the effectiveness of fair value measurement disclosures. Among other provisions, the update removes requirements to disclose amounts and reasons of transfers between Level 1 and Level 2 in the fair value hierarchy, and it modifies the disclosures regarding transfers in and out of Level 3 of the fair value hierarchy. The update requires a discussion regarding the change in unrealized gains and losses included in other comprehensive income for recurring Level 3 fair value measurements held at the end of the reporting period, and the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements. This update will be effective for financial statements issued for fiscal years and interim periods beginning after December 15, 2019. Because the Company does not typically have Level 3 fair value measurements, the update is expected to have an insignificant impact on the Company's financial statements.

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In August 2018, the FASB issued an update which aligns the requirements for capitalizing implementation costs in a cloud-computing arrangement service contract with the requirements for capitalizing implementation costs incurred for an internal-use software license. Implementation costs incurred by customers in a cloud computing arrangement are to be deferred and recognized over the term of the arrangement, if those costs would be capitalized by the customer in a software licensing arrangement under the internal-use software guidance. This update will be effective for financial statements issued for fiscal years and interim periods beginning after December 15, 2019. The Company is currently assessing the impact that the guidance will have on its financial statements.

In August 2018, the FASB issued an update which changes the disclosure of accounting and reporting requirements related to single-employer defined benefit pension or other postretirement benefit plans. The amendments in the update remove disclosures that are no longer considered cost-beneficial, clarify the specific requirements of disclosures and add disclosure requirements identified as relevant. For calendar-year public companies, the changes will be effective for annual periods, including interim periods within those annual periods, in 2020. Because the Company has minimal pension plan provisions that require calculation of projected benefit obligations or accumulated benefit obligations, the update is expected to have an insignificant impact on the Company's financial statements.

In June 2018, the FASB issued an update expanding earlier guidance on stock compensation to include share-based payments issued to nonemployees for goods and services. Consequently, the accounting for share-based payments to nonemployees and employees will be substantially the same. This update will be effective for financial statements issued for fiscal years and interim periods beginning after December 15, 2018. Earlier adoption is permitted. The adoption of this update had an insignificant impact on the Company's financial statements.

In March 2018, the FASB issued an update regarding the accounting implications of the Tax Cuts and Jobs Act (the "Tax Act"). The update clarifies that in a company's financial statements that include the reporting period in which the Tax Act was enacted, a company must first reflect the income tax effects of the Tax Act in which the accounting under U.S. GAAP is complete. Those amounts would not be provisional amounts. The company would also report provisional amounts for those specific income tax effects for which the accounting under U.S. GAAP will be incomplete but for which a reasonable estimate can be determined. If there are income tax effects for the Tax Act for which a reasonable estimate cannot be determined, the company would not report provisional amounts and would continue to apply U.S. GAAP based on the tax laws that were in effect immediately prior to the Tax Act being enacted. This accounting update is effective immediately. The Company believes its accounting for the income tax effects of the Tax Act is complete. Technical corrections or other forthcoming guidance could change how we interpret provisions of the Tax Act, which may impact our effective tax rate and could affect our deferred tax assets, tax positions and/or our tax liabilities.

In February 2018, the FASB issued an update regarding the reclassification of certain tax effects from accumulated other comprehensive income. This update requires a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the newly enacted federal corporate tax rate. The amount of the reclassification would be the difference between the historical 35% corporate income tax rate and the newly enacted 21% corporate tax rate. This update eliminates the stranded tax effects associated with the change in the federal corporate income tax rate in the Tax Act and improves the usefulness of information reported to financial statement users. The amendments are effective for all entities for fiscal years beginning after December 15, 2018 and interim periods within those fiscal years. Early adoption of the amendments is permitted including adoption in any interim period, for public business entities for reporting periods for which financial statements have not yet been issued and all other entities for reporting periods for which financial statements have not yet been made available for issuance. An entity may apply the amendments in the update retrospectively to each period in which the effect of the change in the U.S. federal corporate income tax rate in the Tax Act is recognized. The Company elected to adopt this update in December 2017 and recorded a $420,000 increase to retained earnings and reduction to accumulated other comprehensive income.

In August 2017, the FASB issued an update intended to improve and simplify accounting rules around hedge accounting. Amendments expand and refine hedge accounting for both nonfinancial and financial risk components and align the recognition and presentation of the effects of the hedging instrument and the hedged item in the financial statements. The amendments in this update also make certain targeted improvements to simplify the application of hedge accounting guidance and ease the administrative burden of hedge documentation requirements and assessing hedge effectiveness. In October 2018, the FASB issued an update to permit the use of the Overnight Index Swap ("OIS") rate based on the Secured Overnight Financing Rate ("SOFR") as a benchmark interest rate for hedge accounting purposes. These updates will be effective for financial statements issued for fiscal years and interim periods beginning after December 15, 2018. The adoption of this update had an insignificant impact on the Company's financial statements.

In July 2017, the FASB issued guidance which simplifies the accounting for certain financial instruments with down round features, a provision in an equity-linked financial instrument (or embedded feature) that provides a downward adjustment of the current exercise price based on the price of future equity offerings. The provisions of the new guidance related to down rounds are effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. The Company has no equity-linked financial instruments that have such down round features, therefore the adoption of this update had an insignificant impact on the Company's financial statements.

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In May 2017, the FASB issued an update which provides clarity and reduces diversity in practice when accounting for the modification of terms and conditions for share-based payment awards. Previous accounting guidance did not distinguish between modifications which were substantive from modifications that were merely administrative. The accounting standards update requires entities to account for the effects of a modification unless the following three conditions are met: the fair value of the modified award is the same as the fair value of the original award immediately before the original award is modified; the vesting conditions of the modified award are the same as the vesting conditions of the original award immediately before the original award is modified; and the classification of the modified award as an equity instrument or a liability instrument is the same as the classification of the original award immediately before the original award is modified. This update is effective for annual and interim periods beginning after December 15, 2017. The adoption of this update had an insignificant impact on the Company's financial statements.

In March 2017, the FASB issued an update which shortens the amortization period for certain callable debt securities held at a premium to the earliest call date. Under current GAAP, entities amortize the premium as an adjustment of yield over the contractual life of the instrument even if the holder is certain that the call will be exercised. As a result, upon the exercise of a call on a callable debt security held at a premium, the unamortized premium is recorded as a loss in earnings. The update shortens the amortization period for certain callable debt securities held at a premium and requires the premium be amortized to the earliest call date. This update will be effective for annual and interim periods beginning after December 15, 2018. Entities are required to apply the amendments on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings as of the beginning of the period of adoption. The adoption of this update had an insignificant impact on the Company's financial statements.

In March 2017, the FASB issued an update which changes the presentation of net periodic pension cost and net periodic postretirement benefit cost in a company's income statement. The amendment requires that an employer report the service cost component in the same line item as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit cost are to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations, if one is presented. The amendment is effective for annual and interim periods beginning after December 15, 2017. Because the Company has minimal benefit plan provisions that require the measurement of net periodic pension cost and net periodic postretirement benefit cost, the adoption of this update had an insignificant impact on the Company's financial statements.

In January 2017, the FASB issued an update to simplify the test for goodwill impairment. This amendment eliminates Step 2 from the goodwill impairment test. The annual, or interim, goodwill impairment test is performed by comparing the fair value of a reporting unit with its carrying amount. An impairment charge should be recognized for the amount by which the carrying amount exceeds the reporting unit's fair value. This update will be effective for the Company's financial statements for annual years beginning after December 15, 2019. The adoption of this update is expected to have an insignificant impact on the Company's financial statements.

In January 2017, the FASB issued an update that clarifies the definition of a business as it pertains to business combinations. This amendment affects all companies and other reporting organizations that must determine whether they have sold or acquired a business. This update is effective for the Company's financial statements for fiscal years beginning after December 15, 2017. The adoption of this update had an insignificant impact on the Company's financial statements.

In September 2016, the FASB issued an accounting standards update to address diversity in presentation in how certain cash receipts and cash payments are presented and classified in the statement of cash flows. This update is effective for financial statements issued for fiscal years and interim periods beginning after December 15, 2017. The adoption of this update had an insignificant impact on the Company's consolidated balance sheet or statement of income.

In June 2016, the FASB issued an accounting standards update pertaining to the measurement of credit losses on financial instruments. This update requires the measurement of all expected credit losses for financial instruments held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts.

Financial institutions and other organizations will now use forward-looking information to better inform their credit loss estimates. This update is intended to improve financial reporting by requiring timelier recording of credit losses on loans and other financial instruments held by financial institutions and other organizations. This update will be effective for financial statements issued for fiscal years and interim periods beginning after December 15, 2019. The Company is currently evaluating its existing systems and data to support the new standard as well as assessing the impact that the guidance will have on the Company's consolidated financial statements. The Company has formed a working group under the direction of the Chief Risk Officer that is comprised of individuals from the credit, risk management, finance and project management areas for implementation of this update. In early 2018, the Company contracted with a software and advisory service provider to aid in implementation. The Company continues to work with this service provider in assessing its data and preparing for implementation. In November 2018, the FASB issued additional codification improvements which clarified that operating leases are not part of the credit losses standard, but rather, should be accounted for in accordance with the leases standard.

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In February 2016, FASB issued accounting guidance that requires all lessees to recognize a lease liability and a right-of-use asset, measured at the present value of the future minimum lease payments, at the lease commencement date. Lessor accounting remains largely unchanged under the new guidance. The guidance is effective for fiscal years beginning after December 15, 2018, including interim reporting periods within that reporting period, with early adoption permitted. A modified retrospective approach must be applied for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. In the third quarter of 2018, the FASB issued updates which included targeted improvements to the leasing guidance that is intended to reduce costs and ease implementation of the leases standard. The improvements include an optional transition method to adopt the new leases standard where the entity could initially apply the new leases standard at the adoption date and recognize a cumulative effect adjustment to the opening balance of retained earnings in the period of adoption. Consequently, an entity's reporting for comparative periods presented in the financial statements in which it adopts the new leases standard, will continue to be in accordance with current GAAP in topic 840, Leases. An entity that adopts this additional transition method, must provide the required disclosures for all periods that continue to be in accordance with the current GAAP in Topic 840. The lease update also includes a practical expedient, by class of underlying asset, to not separate nonlease components from the associated lease component and, instead, to account for these components as a single component if the nonlease components otherwise would be accounted for under the new revenue guidance and both of the following conditions are met: 1) the timing and pattern of transfer of the nonlease component(s) and associated lease component are the same, and 2) the lease component, if accounted for separately, would be classified as an operating lease. The Company is adopting the ASUs related to Leases as of January 1, 2019. The Company reviewed its existing lease contracts and service contracts that may include embedded leases. The Company retained the services of a software provider to aid in implementation with the oversight of management. Management identified the complete population of contracts that would be required to be assessed under this standard. Management has elected the transition practical expedient option, which allowed us not to reassess 1) whether any contracts are or contain embedded leases; 2) the lease classification for any leases; and 3) whether initial direct costs meet the new definition, as of the initial adoption date. From the lessee perspective, no embedded leases were identified and we will recognize upon adoption, a Right of Use ("ROU") asset and a lease liability primarily related to real estate leases existing on January 1, 2019. Management is in process of completing its assessment which includes assessment of the leases from the Highlands Bancorp. Inc. acquisition which occurred early in first quarter 2019.

In January 2016, the FASB issued an accounting standards update intended to improve the recognition and measurement of financial instruments. Specifically, the accounting standards update requires all equity instruments, with the exception of those that are accounted for under the equity method of accounting, to be measured at fair value with changes in the fair value recognized through net income. Additionally, public business entities are required to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes. The amendments in this update also require an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments. In February 2018, the FASB issued further guidance that provided technical corrections to this update. Those technical corrections included clarification on accounting for equity securities without a readily determinable fair value, remeasurement requirements on forward contracts and purchased options, and presentation requirements for certain fair value option liabilities. This amendment is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. The adoption of this update required an adjustment on January 1, 2018 from other comprehensive income to retained earnings for the amount of the unrealized gain on equity securities as of December 31, 2017. Thereafter, any increases or decreases to the market value on these equity securities will be recorded through the consolidated statements of income. Please see the Consolidated Statement of Changes in Stockholders' Equity, Note 4 - Investment Securities and Note 17 - Comprehensive Income (Loss) for more information.

In May 2014, the FASB issued an accounting standards update that clarifies the principles for recognizing revenue. The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to a customer in an amount that reflects the consideration to which the entity expects to be entitled in exchange for these goods or services. To achieve that core principle, an entity should apply the following steps: (i) identify the contract(s) with a customer; (ii) identify the performance obligations in the contract; (iii) determine the transaction price; (iv) allocate the transaction price to the performance obligations in the contract; and (v) recognize revenue when (or as) the entity satisfies a performance obligation. In 2016, the FASB issued further implementation guidance regarding revenue recognition. This additional guidance included clarification on certain principal versus agent considerations within the implementation of the guidance as well as clarification related to identifying performance obligations and licensing. The guidance also requires new qualitative and quantitative disclosures, including disaggregation of revenues and descriptions of performance obligations. The guidance along with its updates is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. In evaluating this standard, management has determined that the majority of revenue earned by the Company is from revenue streams not included in the scope of this standard. The Company has assessed its revenue streams and reviewed contracts potentially affected by the guidance including deposit related fees, interchange fees, investment commissions, merchant fee income and other noninterest income sources to determine the potential impact the new guidance is expected to have on the Company’s consolidated financial statements. The Company adopted the guidance on January 1, 2018 using the modified retrospective method. The Company did not have a cumulative-effect adjustment to opening retained earnings as a result of adopting this standard. Please see Note 14 - Revenue Recognition for more information.

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NOTE 2 - ACQUISITIONS

Highlands Bank

On January 4, 2019, the Company completed its acquisition of Highlands Bancorp, Inc. ("Highlands"), a bank holding company headquartered in Vernon, New Jersey. Highlands was the parent of Highlands State Bank, which operated four branches in Sussex, Passaic and Morris Counties in New Jersey. This acquisition enabled the Company to broaden its presence in those counties. Effective as of the close of business on January 4, 2019, Highlands merged into the Company and Highlands State Bank merged into Lakeland. Pursuant to the merger agreement, the shareholders of Highlands received for each outstanding share of Highlands common stock that they owned at the effective time of the merger, 1.015 shares of Lakeland Bancorp, Inc. common stock. The Company issued 2,837,524 shares of its common stock in the merger. Outstanding Highlands options were paid out in cash at the difference between $14.71 and an average strike price of $8.09 for a total cash payment of $797,000. As of January 4, 2019, Highlands had total assets, total loans, total deposits and total capital of $480.8 million, $438.3 million, $408.8 million and $31.2 million, respectively.

The acquisition was accounted for under the acquisition method of accounting and accordingly, the assets acquired and liabilities assumed in the acquisition were recorded at their estimated fair values as of the acquisition date. Highlands' assets were recorded at their preliminary estimated fair values as of January 4, 2019 and Highlands' results of operations will be included in the Company's Consolidated Statements of Income from that date forward.

Harmony Bank

On July 1, 2016, the Company completed its acquisition of Harmony Bank (“Harmony”), a bank located in Ocean County, New Jersey. This merger allowed the Company to expand its presence to Ocean County.

The acquisition was accounted for under the acquisition method of accounting and accordingly, the assets acquired and liabilities assumed in the acquisition were recorded at their estimated fair values based on management’s best estimates using information available at the date of the acquisition, including the use of a third party valuation specialist. Harmony's results of operations have been included in the Company's Consolidated Statements of Income since July 1, 2016.

Pascack Bancorp

On January 7, 2016, the Company completed its acquisition of Pascack Bancorp, Inc. (“Pascack”), a bank holding company headquartered in Waldwick, New Jersey. Pascack was the parent of Pascack Community Bank, which operated 8 branches in Bergen and Essex Counties in New Jersey. This acquisition enabled the Company to broaden its presence in Bergen and Essex counties.

The acquisition was accounted for under the acquisition method of accounting. Accordingly, the assets acquired and liabilities assumed in the acquisition were recorded at their estimated fair values based on management’s best estimates using information available at the date of the acquisition, including the use of a third party valuation specialist. Pascack's results of operations have been included in the Company's Consolidated Statements of Income since January 7, 2016.

Direct costs related to the Highlands, Pascack and Harmony acquisitions were expensed as incurred. During the years ended December 31, 2018 and 2016, the Company incurred $464,000 and $4.1 million, respectively, of merger and acquisition integration-related expenses, which have been separately stated in the Company’s Consolidated Statements of Income. There were no merger or acquisition integration-related expenses in 2017.

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NOTE 3 - EARNINGS PER SHARE

The Company uses the two class method to compute earnings per common share. Participating securities include non-vested restricted stock and non-vested restricted stock units. The following tables present the computation of basic and diluted earnings per share for the periods presented.

Year Ended December 31, 2018	Income (Numerator)	Shares (Denominator)	Per Share Amount
	(in thousands, except per share amounts)		
Basic earnings per share			
Net income available to common shareholders	$63,401	47,578	$ 1.33
Less: earnings allocated to participating securities	(582)	—	(0.01)
Net income available to common shareholders	$62,819	47,578	$ 1.32
Effect of dilutive securities			
Stock options and restricted stock	—	188	—
Diluted earnings per share			
Net income available to common shareholders plus assumed conversions	$62,819	47,766	$ 1.32

Year Ended December 31, 2017	Income (Numerator)	Shares (Denominator)	Per Share Amount
	(in thousands, except per share amounts)		
Basic earnings per share			
Net income available to common shareholders	$52,580	47,438	$ 1.11
Less: earnings allocated to participating securities	(480)	—	(0.01)
Net income available to common shareholders	$52,100	47,438	$ 1.10
Effect of dilutive securities			
Stock options and restricted stock	—	236	(0.01)
Diluted earnings per share			
Net income available to common shareholders plus assumed conversions	$52,100	47,674	$ 1.09

Year Ended December 31, 2016	Income (Numerator)	Shares (Denominator)	Per Share Amount
	(in thousands, except per share amounts)		
Basic earnings per share			
Net income available to common shareholders	$41,518	42,912	$ 0.97
Less: earnings allocated to participating securities	(396)	—	(0.01)
Net income available to common shareholders	$41,122	42,912	$ 0.96
Effect of dilutive securities			
Stock options and restricted stock	—	202	(0.01)
Diluted earnings per share			
Net income available to common shareholders plus assumed conversions	$41,122	$ 43,114	$ 0.95

There were no antidilutive options to purchase common stock to be excluded from the above computations.

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NOTE 4 - INVESTMENT SECURITIES

The amortized cost, gross unrealized gains and losses and the fair value of the Company's available for sale and held to maturity investment securities are as follows:

	December 31, 2018				December 31, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(in thousands)							
AVAILABLE FOR SALE								
U.S. Treasury and U.S. government agencies	$143,495	$ —	$(2,568)	$140,927	$148,968	$ 78	$(1,791)	$147,255
Mortgage-backed securities, residential	434,208	779	(8,843)	426,144	419,538	479	(5,763)	414,254
Mortgage-backed securities, multifamily	21,087	67	(204)	20,950	10,133	7	(63)	10,077
Obligations of states and political subdivisions	45,951	140	(586)	45,505	51,289	448	(417)	51,320
Debt securities	5,000	92	—	5,092	5,000	140	—	5,140
	$649,741	$ 1,078	$(12,201)	$638,618	$634,928	$ 1,152	$(8,034)	$628,046

	December 31, 2018				December 31, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(in thousands)							
HELD TO MATURITY								
U.S. government agencies	$33,025	$ —	$(677)	$32,348	$33,415	$ 24	$(402)	$33,037
Mortgage-backed securities, residential	75,859	169	(1,838)	74,190	54,991	249	(978)	54,262
Mortgage-backed securities, multifamily	1,853	—	(35)	1,818	1,957	—	(22)	1,935
Obligations of states and political subdivisions	37,909	113	(328)	37,694	43,318	306	(188)	43,436
Debt securities	5,000	—	(118)	4,882	6,004	14	—	6,018
	$153,646	$ 282	$(2,996)	$150,932	$139,685	$ 593	$(1,590)	$138,688

The following table lists contractual maturities of investment securities classified as available for sale and held to maturity at December 31, 2018. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(in thousands)			
Due in one year or less	$30,766	$30,614	$7,061	$7,066
Due after one year through five years	104,519	102,754	42,103	41,720
Due after five years through ten years	40,768	40,108	23,752	23,185
Due after ten years	18,393	18,048	3,018	2,953
	194,446	191,524	75,934	74,924
Mortgage-backed securities	455,295	447,094	77,712	76,008
Total securities	$649,741	$638,618	$153,646	$150,932

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The following table shows proceeds from sales of securities, gross gains and gross losses on sales and calls of securities for the periods indicated:

	Years Ended December 31,		
	2018	2017	2016
	(in thousands)		
Sale proceeds	$—	$4,500	$15,654
Gross gains	—	2,539	370
Gross losses	—	(15)	—

Gains or losses on sales of securities are based on the net proceeds and the adjusted carrying amount of the securities sold using the specific identification method.

Securities with a carrying value of approximately $476.3 million and $400.4 million at December 31, 2018 and 2017, respectively, were pledged to secure public deposits and for other purposes required by applicable laws and regulations.

The following tables indicates the length of time individual securities have been in a continuous unrealized loss position at December 31, 2018 and 2017:

December 31, 2018	Less than 12 Months		12 Months or Longer		Total		
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Number of Securities	Fair Value	Unrealized Losses
	(dollars in thousands)						
AVAILABLE FOR SALE							
U.S. Treasury and U.S. government agencies	$20,588	$ 216	$120,338	$ 2,352	27	$140,926	$ 2,568
Mortgage-backed securities, residential	10,119	58	316,851	8,785	139	326,970	8,843
Mortgage-backed securities, multifamily	1,977	2	12,911	202	4	14,888	204
Obligations of states and political subdivisions	1,289	2	26,522	584	50	27,811	586
	$33,973	$ 278	$476,622	$ 11,923	220	$510,595	$ 12,201
HELD TO MATURITY							
U.S. government agencies	$—	$ —	$32,348	$ 677	6	$32,348	$ 677
Mortgage-backed securities, residential	8,325	59	53,761	1,779	36	62,086	1,838
Mortgage-backed securities, multifamily	—	—	1,818	35	2	1,818	35
Obligations of states and political subdivisions	1,764	8	15,580	320	27	17,344	328
Debt securities	3,882	118	—	—	1	3,882	118
	$13,971	$ 185	$103,507	$ 2,811	72	$117,478	$ 2,996

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December 31, 2017	Less than 12 Months		12 Months or Longer		Total		
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Number of securities	Fair Value	Unrealized Losses
	(dollars in thousands)						
AVAILABLE FOR SALE							
U.S. Treasury and U.S. government agencies	$80,391	$ 646	$54,769	$ 1,145	27	$135,160	$ 1,791
Mortgage-backed securities, residential	199,387	1,723	157,739	4,040	118	357,126	5,763
Mortgage-backed securities, multifamily	—	—	5,088	63	1	5,088	63
Obligations of states and political subdivisions	9,612	77	12,970	340	39	22,582	417
	$289,390	$ 2,446	$230,566	$ 5,588	185	$519,956	$ 8,034
HELD TO MATURITY							
U.S. government agencies	$15,371	$ 95	$6,720	$ 307	4	$22,091	$ 402
Mortgage-backed securities, residential	26,090	426	19,203	552	25	45,293	978
Mortgage-backed securities, multifamily	1,935	22	—	—	2	1,935	22
Obligations of states and political subdivisions	15,353	56	6,028	132	23	21,381	188
	$58,749	$ 599	$31,951	$ 991	54	$90,700	$ 1,590

Management has evaluated the securities in the above table and has concluded that none of the securities with unrealized losses has impairments that are other-than-temporary. Fair value below cost is solely due to interest rate movements and is deemed temporary.

Investment securities, including the mortgage-backed securities and corporate securities, are evaluated on a periodic basis to determine if factors are identified that would require further analysis. In evaluating the Company's securities, management considers the following items:

- The Company's ability and intent to hold the securities, including an evaluation of the need to sell the security to meet certain liquidity measures, or whether the Company has sufficient levels of cash to hold the identified security in order to recover the entire amortized cost of the security;
- The financial condition of the underlying issuer;
- The credit ratings of the underlying issuer and if any changes in the credit rating have occurred;
- The length of time the security's fair value has been less than amortized cost; and
- Adverse conditions related to the security or its issuer if the issuer has failed to make scheduled payments or other factors.

If the above factors indicate an additional analysis is required, management will perform a discounted cash flow analysis evaluating the security.

Equity securities at fair value

The Company has an equity securities portfolio, which consists of investments in other financial institutions for market appreciation purposes and investments in Community Reinvestment funds. The market value of these investments was $15.9 million and $18.1 million as of December 31, 2018 and 2017, respectively. Upon implementation of Accounting Standards Update 2016-01 - Financial Instruments ("ASU 2016-01"), the Company made a cumulative adjustment of $2.0 million from other comprehensive income to retained earnings as of January 1, 2018. In the twelve months ended December 31, 2018, the Company recorded $583,000 in market value loss on equity securities in noninterest income.

As of December 31, 2018, the equity investments in other financial institutions and Community Reinvestment funds had a market value of $2.7 million and $13.2 million, respectively. The Community Reinvestment funds include $3.5 million that are primarily invested in community development loans that are guaranteed by the Small Business Administration ("SBA"). Because the funds are primarily guaranteed by the federal government there are minimal changes in market value between accounting periods. These funds can be redeemed within 60 days' notice at the net asset value less unpaid management fees with the approval of the fund manager. As of December 31, 2018, the net amortized cost equaled the market value of the investment. There are no unfunded commitments related to these investments.

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The Community Reinvestment funds also include funds that are invested in government guaranteed loans, mortgage-backed securities, small business loans and other instruments supporting affordable housing and economic development. The Company may redeem these funds at the net asset value calculated at the end of the current business day less any unpaid management fees. As of December 31, 2018, the amortized cost of these securities was $10.4 million and the fair value was $9.7 million. There are no restrictions on redemptions for the holdings in these investments other than the notice required by the fund manager. There are no unfunded commitments related to this investment.

NOTE 5 - LOANS AND LEASES AND OTHER REAL ESTATE

The following sets forth the composition of Lakeland's loan and lease portfolio:

	December 31,	
	2018	2017
	(in thousands)	
Commercial, secured by real estate	$3,057,779	$2,831,184
Commercial, industrial and other	336,735	340,400
Leases	87,925	75,039
Real estate - residential mortgage	329,854	322,880
Real estate - construction	319,545	264,908
Home equity and consumer	328,609	322,269
Total loans and leases	4,460,447	4,156,680
Less deferred fees	(3,714)	(3,960)
Loans and leases, net of deferred fees	$4,456,733	$4,152,720

At December 31, 2018 and December 31, 2017, Lakeland had $1.2 billion and $1.1 billion in loans pledged for potential borrowings at the Federal Home Loan Bank of New York ("FHLB"). As of December 31, 2018 and 2017, home equity and consumer loans included overdraft deposit balances of $452,000 and $966,000, respectively.

Purchased Credit Impaired Loans

The carrying value of loans acquired in the Pascack acquisition and accounted for in accordance with ASC Subtopic 310-30, "Loans and Debt Securities Acquired with Deteriorated Credit Quality," was $157,000 at December 31, 2018, which was $661,000 less than the balance at the time of acquisition on January 7, 2016. In the first quarter of 2017, one of the Pascack purchased credit impaired ("PCI") loans totaling $127,000 experienced further credit deterioration and was fully charged off. Also in the second quarter of 2017, one of the Pascack PCI loans totaling $218,000 was fully paid off. The carrying value of loans acquired in the Harmony acquisition was $495,000 at December 31, 2018 which was $274,000 less than the balance at the acquisition date on July 1, 2016. In the second quarter of 2017, a Harmony PCI loan with a net value of $247,000 was fully paid off.

Under ASC Subtopic 310-30, PCI loans may be aggregated and accounted for as pools of loans if the loans being aggregated have common risk characteristics. The Company elected to account for the loans with evidence of credit deterioration individually rather than aggregate them into pools.

The following table presents changes in the accretable yield for PCI loans (in thousands):

	Years Ended December 31,	
	2018	2017
Balance, beginning of period	$129	$145
Accretion	(182)	(202)
Net reclassification non-accretable difference	134	186
Balance, end of period	$81	$129

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Portfolio Segments

Lakeland currently manages its credit products and the respective exposure to credit losses (credit risk) by the following specific portfolio segments which are levels at which Lakeland develops and documents its systematic methodology to determine the allowance for loan and lease losses attributable to each respective portfolio segment. These segments are:

- Commercial, secured by real estate - consists of commercial mortgage loans secured by owner occupied properties and non-owner occupied properties. The loans secured by owner occupied properties involve a variety of property types to conduct the borrower's operations. The primary source of repayment for this type of loan is the cash flow from the business and is based upon the borrower's financial health and the ability of the borrower and the business to repay. The loans secured by non-owner occupied properties involve investment properties for warehouse, retail, office space, etc., with a history of occupancy and cash flow. This commercial real estate category contains mortgage loans to the developers and owners of commercial real estate where the borrower intends to operate or sell the property at a profit and use the income stream or proceeds from the sale to repay the loan.
- Commercial, industrial and other - are loans made to provide funds for equipment and general corporate needs. Repayment of a loan primarily uses the funds obtained from the operation of the borrower's business. Commercial loans also include lines of credit that are utilized to finance a borrower's short-term credit needs and/or to finance a percentage of eligible receivables and inventory.
- Leases - includes a small portfolio of equipment leases, which consists of leases primarily for essential equipment used by small to medium sized businesses.
- Real estate - residential mortgage - contains permanent mortgage loans principally to consumers secured by residential real estate. Residential real estate loans are evaluated for the adequacy of repayment sources at the time of approval, based upon measures including credit scores, debt-to-income ratios, and collateral values. Loans may be either conforming or non-conforming.
- Real estate - construction - construction loans, as defined, are intended to finance the construction of commercial properties and include loans for the acquisition and development of land. Construction loans represent a higher degree of risk than permanent real estate loans and may be affected by a variety of factors such as the borrower's ability to control costs and adhere to time schedules and the risk that constructed units may not be absorbed by the market within the anticipated time frame or at the anticipated price. The loan commitment on these loans often includes an interest reserve to pay interest charges on the outstanding balance of the loan.
- Home equity and consumer - includes primarily home equity loans and lines, installment loans, personal lines of credit and automobile loans. The home equity category consists mainly of loans and revolving lines of credit to consumers which are secured by residential real estate. These loans are typically secured with second mortgages on the homes, although many are secured with first mortgages. Other consumer loans include installment loans used by customers to purchase automobiles, boats and recreational vehicles.

Non-accrual and Past Due Loans

The following schedule sets forth certain information regarding Lakeland's non-accrual loans and leases, its other real estate owned and other repossessed assets, and accruing troubled debt restructurings ("TDRs") (in thousands):

	At December 31,	
	2018	2017
Commercial, secured by real estate	$7,192	$5,890
Commercial, industrial and other	1,019	184
Leases	501	144
Real estate - residential mortgage	1,986	3,860
Real estate - construction	—	1,472
Home equity and consumer	1,432	2,105
Total non-accrual loans and leases	12,130	13,655
Other real estate and other repossessed assets	830	843
Total non-performing assets	$12,960	$14,498

Troubled debt restructurings, still accruing	$9,293	$11,462

Non-accrual loans included $3.6 million and $2.7 million of TDRs for the years ended December 31, 2018 and 2017, respectively. As of December 31, 2018, the Company had $1.5 million in residential mortgages and consumer home equity loans included in the table above that were in the process of foreclosure.

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An age analysis of past due loans, segregated by class of loans as of December 31, 2018 and 2017, is as follows:

December 31, 2018	30-59 Days Past Due	60-89 Days Past Due	Greater Than 89 Days	Total Past Due	Current	Total Loans and Leases	Recorded Investment Greater than 89 Days and Still Accruing
	(in thousands)						
Commercial, secured by real estate	$1,477	$ 639	$ 2,237	$4,353	$3,053,426	$3,057,779	$ —
Commercial, industrial and other	173	243	750	1,166	335,569	336,735	—
Leases	533	13	501	1,047	86,878	87,925	—
Real estate - residential mortgage	743	111	1,776	2,630	327,224	329,854	—
Real estate - construction	—	—	—	—	319,545	319,545	—
Home equity and consumer	1,917	216	850	2,983	325,626	328,609	—
	$4,843	$ 1,222	$ 6,114	$ 12,179	$4,448,268	$4,460,447	$ —

December 31, 2017	30-59 Days Past Due	60-89 Days Past Due	Greater Than 89 Days	Total Past Due	Current	Total Loans and Leases	Recorded Investment Greater than 89 Days and Still Accruing
	(in thousands)						
Commercial, secured by real estate	$3,663	$ 1,082	$3,817	$8,562	$2,822,622	$2,831,184	$ —
Commercial, industrial and other	80	121	56	257	340,143	340,400	—
Leases	496	139	144	779	74,260	75,039	—
Real estate - residential mortgage	939	908	3,137	4,984	317,896	322,880	—
Real estate - construction	—	—	1,472	1,472	263,436	264,908	—
Home equity and consumer	1,258	310	1,386	2,954	319,315	322,269	200
	$6,436	$ 2,560	$10,012	$19,008	$4,137,672	$4,156,680	$ 200

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Impaired Loans

Lakeland's policy regarding impaired loans is discussed in Note 1 – Summary of Accounting Policies – Loans and Leases and Allowance for Loan and Lease Losses. The Company defines impaired loans as all non-accrual loans with recorded investments of $500,000 or greater. Impaired loans also includes all loans modified in troubled debt restructurings. The following tables represent the Company's impaired loans at December 31, 2018, 2017 and 2016.

December 31, 2018	Recorded Investment in Impaired Loans	Contractual Unpaid Principal Balance	Related Allowance	Interest Income Recognized	Average Investment in Impaired Loans
	(in thousands)				
Loans without related allowance:					
Commercial, secured by real estate	$9,284	$ 9,829	$ —	$ 188	$ 7,369
Commercial, industrial and other	1,151	1,449	—	19	1,834
Leases	301	597	—	—	376
Real estate - residential mortgage	—	—	—	4	242
Real estate - construction	—	—	—	—	726
Home equity and consumer	—	—	—	—	—
Loans with related allowance:					
Commercial, secured by real estate	7,270	7,597	307	317	7,594
Commercial, industrial and other	209	209	7	12	209
Leases	30	30	14	—	19
Real estate - residential mortgage	730	884	4	20	745
Real estate - construction	—	—	—	—	—
Home equity and consumer	727	765	6	32	898
Total:					
Commercial, secured by real estate	$16,554	$ 17,426	$ 307	$ 505	$ 14,963
Commercial, industrial and other	1,360	1,658	7	31	2,043
Leases	331	627	14	—	395
Real estate - residential mortgage	730	884	4	24	987
Real estate - construction	—	—	—	—	726
Home equity and consumer	727	765	6	32	898
	$19,702	$ 21,360	$ 338	$ 592	$ 20,012

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December 31, 2017	Recorded Investment in Impaired Loans	Contractual Unpaid Principal Balance	Related Allowance	Interest Income Recognized	Average Investment in Impaired Loans
	(in thousands)				
Loans without related allowance:					
Commercial, secured by real estate	$12,155	$ 12,497	$ —	$ 366	$ 12,774
Commercial, industrial and other	618	618	—	25	618
Leases	—	—	—	—	—
Real estate - residential mortgage	963	980	—	15	996
Real estate - construction	1,471	1,471	—	—	1,471
Home equity and consumer	—	—	—	—	6
Loans with related allowance:					
Commercial, secured by real estate	5,381	5,721	454	206	5,029
Commercial, industrial and other	164	164	9	14	283
Leases	65	65	30	—	29
Real estate - residential mortgage	781	919	4	27	940
Real estate - construction	—	—	—	—	—
Home equity and consumer	993	1,026	8	52	1,090
Total:					
Commercial, secured by real estate	$17,536	$ 18,218	$ 454	$ 572	$ 17,803
Commercial, industrial and other	782	782	9	39	901
Leases	65	65	30	—	29
Real estate - residential mortgage	1,744	1,899	4	42	1,936
Real estate - construction	1,471	1,471	—	—	1,471
Home equity and consumer	993	1,026	8	52	1,096
	$22,591	$ 23,461	$ 505	$ 705	$ 23,236

December 31, 2016	Recorded Investment in Impaired Loans	Contractual Unpaid Principal Balance	Related Allowance	Interest Income Recognized	Average Investment in Impaired Loans
	(in thousands)				
Loans without related allowance:					
Commercial, secured by real estate	$12,764	$ 13,195	$ —	$ 229	$ 13,631
Commercial, industrial and other	603	603	—	24	1,109
Leases	—	—	—	—	—
Real estate - residential mortgage	1,880	3,146	—	16	2,430
Real estate - construction	1,471	1,471	—	—	12
Home equity and consumer	139	139	—	—	388
Loans with related allowance:					
Commercial, secured by real estate	5,860	6,142	392	273	6,549
Commercial, industrial and other	349	349	12	17	360
Leases	—	—	—	—	1
Real estate - residential mortgage	1,031	1,100	31	30	1,011
Real estate - construction	—	—	—	—	—
Home equity and consumer	1,188	1,211	94	59	1,184
Total:					
Commercial, secured by real estate	$18,624	$ 19,337	$ 392	$ 502	$ 20,180

Commercial, industrial and other	952	952	12	41	1,469
Leases	—	—	—	—	1
Real estate - residential mortgage	2,911	4,246	31	46	3,441
Real estate - construction	1,471	1,471	—	—	12
Home equity and consumer	1,327	1,350	94	59	1,572
	$25,285	$ 27,356	$ 529	$ 648	$ 26,675

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Interest which would have been accrued on impaired loans and leases during 2018, 2017 and 2016 was $1.1 million, $1.5 million and $1.7 million, respectively.

Credit Quality Indicators

The class of loans are determined by internal risk rating. Management closely and continually monitors the quality of its loans and leases and assesses the quantitative and qualitative risks arising from the credit quality of its loans and leases. It is the policy of Lakeland to require that a Credit Risk Rating be assigned to all commercial loans and loan commitments. The Credit Risk Rating System has been developed by management to provide a methodology to be used by Loan Officers, Department Heads and Senior Management in identifying various levels of credit risk that exist within Lakeland’s loan portfolios. The risk rating system assists Senior Management in evaluating Lakeland’s loan portfolio, analyzing trends and determining the proper level of required reserves to be recommended to the Board. In assigning risk ratings, management considers, among other things, a borrower’s debt service coverage, earnings strength, loan to value ratios, industry conditions and economic conditions. Management categorizes loans and commitments into a one (1) to nine (9) numerical structure with rating 1 being the strongest rating and rating 9 being the weakest. Ratings 1 through 5W are considered “Pass” ratings. “Pass” ratings on loans are given to loans that management considers to be of acceptable or better quality. A rating of 5W, or “Watch” is a loan that requires more than the usual amount of monitoring due to declining earnings, strained cash flow, increasing leverage and/or weakening market. These borrowers generally have limited additional debt capacity and modest coverage and average or below average asset quality, margins and market share. Rating 6, “Other Assets Especially Mentioned” is used for loans exhibiting identifiable credit weakness which if not checked or corrected could weaken the loan quality or inadequately protect the bank’s credit position at some future date. Rating 7, “Substandard,” is used on loans that are inadequately protected by the current sound worth and paying capacity of the obligors or of the collateral pledged, if any. A substandard loan has a well-defined weakness or weaknesses that may jeopardize the liquidation of the debt. Rating 8, “Doubtful,” are loans that exhibit all of the weaknesses inherent in substandard loans, but have the added characteristics that the weaknesses make collection or liquidation in full improbable on the basis of existing facts. Rating 9, “Loss,” is a rating for loans or portions of loans that are considered uncollectible and of such little value that their continuance as bankable loans is not warranted.

The following table shows Lakeland’s commercial loan portfolio as of December 31, 2018 and 2017, by the risk ratings discussed above (in thousands):

December 31, 2018 RISK RATING	Commercial, Secured by Real Estate	Commercial, Industrial and Other	Real Estate - Construction
1	$ —	$ 1,119	$ —
2	—	18,462	—
3	69,995	36,367	—
4	933,577	91,145	17,375
5	1,910,423	168,474	297,625
5W - Watch	61,626	7,798	3,493
6 - Other assets especially mentioned	38,844	2,033	—
7 - Substandard	43,314	11,337	1,052
8 - Doubtful	—	—	—
9 - Loss	—	—	—
Total	$ 3,057,779	$ 336,735	$ 319,545

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December 31, 2017 RISK RATING	Commercial, Secured by Real Estate	Commercial, Industrial and Other	Real Estate - Construction
1	$ —	$ 392	$ —
2	—	26,968	—
3	76,824	35,950	—
4	862,537	96,426	15,502
5	1,779,908	150,928	246,806
5W - Watch	47,178	8,779	—
6 - Other assets especially mentioned	40,245	8,670	—
7 - Substandard	24,492	12,287	2,600
8 - Doubtful	—	—	—
9 - Loss	—	—	—
Total	$ 2,831,184	$ 340,400	$ 264,908

This table does not include residential mortgage loans, consumer loans, or leases because they are evaluated on their payment status as pass or substandard, which is defined as non-accrual or past due 90 days or more.

Allowance for Loan and Lease Losses

The following table details activity in the allowance for loan and lease losses by portfolio segment and the related recorded investment in loans and leases for the years ended December 31, 2018 and 2017:

December 31, 2018	Commercial, Secured by Real Estate	Commercial, Industrial and Other	Leases	Real Estate - Residential Mortgage	Real Estate - Construction	Home Equity and Consumer	Total
	(in thousands)						
Beginning balance	$ 25,704	$ 2,313	$ 630	$ 1,557	$ 2,731	$ 2,520	$ 35,455
Charge-offs	(421)	(1,452)	(507)	(131)	(248)	(588)	(3,347)
Recoveries	468	317	23	10	17	332	1,167
Provision	2,130	564	841	130	515	233	4,413
Ending balance	$ 27,881	$ 1,742	$ 987	$ 1,566	$ 3,015	$ 2,497	$ 37,688
Allowance for Loan and Leases Losses							
Ending balance: Individually evaluated for impairment	$ 307	$ 7	$ 14	$ 4	$ —	$ 6	$ 338
Ending balance: Collectively evaluated for impairment	27,574	1,735	973	1,562	3,015	2,491	37,350
Ending balance	$ 27,881	$ 1,742	$ 987	$ 1,566	$ 3,015	$ 2,497	$ 37,688
Loans and Leases							
Ending balance: Individually evaluated for impairment	$ 16,554	$ 1,360	$ 331	$ 730	$ —	$ 727	$ 19,702
Ending balance: Collectively evaluated for impairment	3,040,573	335,375	87,594	329,124	319,545	327,882	4,440,093
Ending balance: Loans acquired with deteriorated credit quality	652	—	—	—	—	—	652
Ending balance (1)	$ 3,057,779	$ 336,735	$ 87,925	$ 329,854	$ 319,545	$ 328,609	$ 4,460,447

(1) Excludes deferred fees

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December 31, 2017	Commercial, Secured by Real Estate	Commercial, Industrial and Other	Leases	Real Estate - Residential Mortgage	Real Estate - Construction	Home Equity and Consumer	Total
	(in thousands)						
Beginning balance	$21,223	$1,723	$548	$1,964	$2,352	$3,435	$31,245
Charge-offs	(762)	(477)	(305)	(441)	(609)	(852)	(3,446)
Recoveries	396	172	59	5	31	903	1,566
Provision	4,847	895	328	29	957	(966)	6,090
Ending balance	$25,704	$2,313	$630	$1,557	$2,731	$2,520	$35,455
Allowance for Loan and Leases Losses							
Ending balance: Individually evaluated for impairment	$454	$9	$30	$4	$—	$8	$505
Ending balance: Collectively evaluated for impairment	25,250	2,304	600	1,553	2,731	2,512	34,950
Ending balance	$25,704	$2,313	$630	$1,557	$2,731	$2,520	$35,455
Loans and Leases							
Ending balance: Individually evaluated for impairment	$17,536	$782	$65	$1,744	$1,471	$993	$22,591
Ending balance: Collectively evaluated for impairment	2,812,941	339,618	74,974	321,136	263,437	321,273	4,133,379
Ending balance: Loans acquired with deteriorated credit quality	707	—	—	—	—	3	710
Ending balance (1)	$2,831,184	$340,400	$75,039	$322,880	$264,908	$322,269	$4,156,680

(1) Excludes deferred fees

Lakeland also maintains a reserve for unfunded lending commitments which are included in other liabilities. This reserve was $2.3 million and $2.5 million as of December 31, 2018 and December 31, 2017, respectively. Lakeland analyzes the adequacy of the reserve for unfunded lending commitments in conjunction with its analysis of the adequacy of the allowance for loan and lease losses. For more information on this analysis, see “Risk Elements” in Management’s Discussion and Analysis.

Troubled Debt Restructurings

Troubled Debt Restructurings ("TDRs") are those loans where significant concessions have been made to borrowers experiencing financial difficulties. Restructured loans typically involve a modification of terms such as a reduction of the stated interest rate lower than the current market rate of a new loan with similar risk, an extended moratorium of principal payments and/or an extension of the maturity date. Lakeland considers the potential losses on these loans as well as the remainder of its impaired loans when considering the adequacy of the allowance for loan losses.

The following table summarizes loans and leases that have been restructured during the periods presented:

	For the Year Ended December 31, 2018			For the Year Ended December 31, 2017		
	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Number of Contracts	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
	(dollars in thousands)					
Commercial, secured by real estate	5	$ 3,348	$ 3,348	8	$ 4,618	$ 4,618
Commercial, industrial and other	1	950	950	2	124	124

Leases	1 15	15	6 65	65
	7 $ 4,313	$ 4,313	16 $ 4,807	$ 4,807

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The following table presents loans and leases modified as TDRs within the previous 12 months from December 31, 2018 and 2017 that have defaulted during the subsequent twelve months:

	For the Year Ended December 31, 2018		For the Year Ended December 31, 2017	
	Number of Contracts	Recorded Investment	Number of Contracts	Recorded Investment
	(dollars in thousands)			
Commercial, secured by real estate	1	$ 171	—	$ —
Leases	—	$ —	2	$ 35
	1	$ 171	2	$ 35

Related Party Loans

Lakeland has entered into lending transactions in the ordinary course of business with directors, executive officers, principal stockholders and affiliates of such persons on similar terms, including interest rates and collateral, as those prevailing for comparable transactions with other borrowers not related to Lakeland. At December 31, 2018 and 2017, loans to these related parties amounted to $53.1 million and $27.5 million, respectively. There were new loans of $18.7 million to related parties and repayments of $10.8 million from related parties in 2018. There was also a net addition of $17.7 million in existing loans for related party relationships that either commenced or ceased during 2018.

Mortgages Held for Sale

Residential mortgages originated by the bank and held for sale in the secondary market are carried at the lower of cost or fair market value. Fair value is generally determined by the value of purchase commitments on individual loans. Losses are recorded as a valuation allowance and charged to earnings. As of December 31, 2018, Lakeland had $1.1 million in mortgages held for sale compared to $456,000 as of December 31, 2017.

Lease Receivables

Future minimum lease payments of lease receivables are expected as follows (in thousands):

2019	$30,384
2020	24,297
2021	18,089
2022	10,814
2023	3,969
Thereafter	372
	$87,925

Other Real Estate and Other Repossessed Assets

At December 31, 2018, Lakeland had other real estate and other repossessed assets of $830,000 and $0, respectively. The other real estate that the Company held at December 31, 2018 consisted of $702,000 in residential property acquired as a result of foreclosure proceedings or through a deed in lieu of foreclosure. At December 31, 2017, Lakeland had other real estate and other repossessed assets of $843,000 and $0, respectively. The other real estate that the Company held at December 31, 2017 consisted of $843,000 in residential property acquired as a result of foreclosure proceedings or through a deed in lieu of foreclosure. For the years ended December 31, 2018, 2017 and 2016, Lakeland had writedowns of $70,000, $98,000 and $0, respectively, on other real estate and other repossessed assets which are included in other real estate and repossessed asset expense in the Consolidated Statement of Income.

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NOTE 6 - PREMISES AND EQUIPMENT

	Estimated Useful Lives	December 31, 2018	2017
		(in thousands)	
Land	Indefinite	$10,471	$10,626
Buildings and building improvements	10 to 50 years	47,006	46,985
Leasehold improvements	10 to 25 years	12,880	12,953
Furniture, fixtures and equipment	2 to 30 years	27,858	26,923
		98,215	97,487
Less accumulated depreciation and amortization		49,040	47,174
		$49,175	$50,313

Depreciation expense was $5.3 million, $5.0 million and $5.0 million for the years ended December 31, 2018, 2017 and 2016, respectively.

NOTE 7 - TIME DEPOSITS

At December 31, 2018, the schedule of maturities of certificates of deposit is as follows (in thousands):

Year	
2019	$568,350
2020	108,881
2021	35,698
2022	41,235
2023	2,874
	$757,038

NOTE 8 - DEBT

Lines of Credit

As a member of the Federal Home Loan Bank of New York ("FHLB"), Lakeland has the ability to borrow overnight based on the market value of collateral pledged. At both December 31, 2018 and 2017, there were no overnight borrowings from the FHLB. As of December 31, 2018, Lakeland also had overnight federal funds lines available for it to borrow up to $210.0 million. Lakeland borrowed $192.1 million and $80.0 million against these lines as of December 31, 2018 and 2017, respectively. Lakeland may also borrow from the discount window of the Federal Reserve Bank of New York based on the market value of collateral pledged. Lakeland had no borrowings with the Federal Reserve Bank of New York as of December 31, 2018 or 2017.

Federal Funds Purchased and Securities Sold Under Agreements to Repurchase

Short-term borrowings at December 31, 2018 and 2017 consisted of short-term securities sold under agreements to repurchase and federal funds purchased. Securities underlying the agreements were under Lakeland’s control. The following tables summarize information relating to securities sold under agreements to repurchase and federal funds purchased for the years presented. For purposes of the tables, the average amount outstanding was calculated based on a daily average.

Federal Funds Purchased	2018	2017	2016
	(dollars in thousands)		
Balance at December 31,	$192,064	$80,000	$32,000
Interest rate at December 31,	2.88 %	1.71 %	0.85 %
Maximum amount outstanding at any month-end during the year	$214,165	$168,784	$133,434
Average amount outstanding during the year	$21,338	$13,264	$8,708
Weighted average interest rate during the year	2.03 %	1.42 %	0.71 %

Securities Sold Under Agreements to Repurchase	2018		2017		2016	
	(dollars in thousands)					
Balance at December 31,	$41,841		$44,936		$24,354	
Interest rate at December 31,	0.26	%	0.02	%	0.02	%
Maximum amount outstanding at any month-end during the year	$50,526		$44,936		$32,872	
Average amount outstanding during the year	$32,435		$28,480		$27,535	
Weighted average interest rate during the year	0.12	%	0.03	%	0.03	%

Other Borrowings

FHLB Debt

At December 31, 2018, advances from the FHLB totaling $181.1 million, with a weighted average interest rate of 2.10%, will mature within 5 years. These advances are collateralized by certain securities and first mortgage loans. At December 31, 2017, advances from the FHLB totaling $172.0 million, with a weighted average interest rate of 1.69%, will mature within 4 years. These advances are collateralized by certain securities and first mortgage loans.

FHLB debt matures as follows (in thousands):

2019	$40,264
2020	55,880
2021	44,971
2022	15,566
2023	24,437
	$181,118

In the first quarter of 2017, the Company repaid an aggregate of $34.0 million in advances from the FHLB and recorded $638,000 in long-term debt prepayment fees.

Long-term Securities Sold Under Agreements to Repurchase

At December 31, 2018, Lakeland had no long-term securities sold under agreements to repurchase compared to $20.0 million at December 31, 2017. In the second quarter of 2018, the Company repaid all of its $20.0 million in matured long-term securities sold under agreements to repurchase. These borrowings were collateralized by certain securities. The borrowings had a weighted average interest rate of 2.25% on December 31, 2017. In the first quarter of 2017, the Company repaid an aggregate of $20.0 million in long-term securities sold under agreements to repurchase and recorded $2.2 million in long-term debt prepayment fees.

The above FHLB debt and long-term securities sold under agreements to repurchase are collateralized by certain securities. At times the market value of securities collateralizing our borrowings may decline due to changes in interest rates and may necessitate our lenders to issue a “margin call” which requires Lakeland to pledge additional securities to meet that margin call. As of December 31, 2018, the Company had $57.7 million in mortgage-backed securities pledged for its short-term securities sold under agreements to repurchase.

Subordinated Debentures

On September 30, 2016, the Company completed an offering of $75.0 million of fixed to floating rate subordinated notes due September 30, 2026. The notes will bear interest at a rate of 5.125% per annum until September 30, 2021 and will then reset quarterly to the then current three-month LIBOR plus 397 basis points until maturity in September 30, 2026, or their earlier redemption. The debt is included in Tier 2 capital for the Company. Debt issuance costs totaled $1.5 million and are being amortized to maturity. Subordinated debt is presented net of issuance costs on the consolidated balance sheet.

In May 2007, the Company issued $20.6 million of junior subordinated debentures due August 31, 2037 to Lakeland Bancorp Capital Trust IV, a Delaware business trust. The distribution rate on these securities was 6.61% for 5 years and floats at LIBOR plus 152 basis points thereafter. The debentures are the sole asset of the Trust. The Trust issued 20,000 shares of trust preferred securities, $1,000 face value, for total proceeds of $20.0 million. The Company’s obligations under the debentures and related documents, taken together, constitute a full, irrevocable and unconditional guarantee on a subordinated basis by the Company of the Trust’s obligations under the preferred securities. The preferred securities are callable by the Company on or after August 1, 2012, or earlier if the deduction of related interest for federal income taxes is prohibited, treatment as Tier I capital is no longer permitted, or certain other contingencies arise. The preferred securities must be redeemed upon maturity of the debentures in 2037. On August 3, 2015, the Company acquired and extinguished $10.0 million of Lakeland Bancorp Capital Trust IV debentures and recorded a $1.8 million gain on the extinguishment of debt.

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In June 2003, the Company issued $20.6 million of junior subordinated debentures due June 30, 2033 to Lakeland Bancorp Capital Trust II, a Delaware business trust. The distribution rate on these securities was 5.71% for 5 years and floats at LIBOR plus 310 basis points thereafter. The debentures are the sole asset of the Trust. The Trust issued 20,000 shares of trust preferred securities, $1,000 face value, for total proceeds of $20.0 million. The Company's obligations under the debentures and related documents, taken together, constitute a full, irrevocable and unconditional guarantee on a subordinated basis by the Company of the Trust's obligations under the preferred securities. The preferred securities are callable by the Company on or after June 30, 2008, or earlier if the deduction of related interest for federal income taxes is prohibited, treatment as Tier I capital is no longer permitted, or certain other contingencies arise. The preferred securities must be redeemed upon maturity of the debentures in 2033.

In June 2016, the Company entered into two cash flow swaps totaling $30.0 million in order to hedge the variable cash outflows associated with the junior subordinated debentures issued to Lakeland Capital Trust II and Lakeland Capital Trust IV. For more information please see Note 19 – Derivatives.

NOTE 9 - STOCKHOLDERS' EQUITY

On December 14, 2016, the Company successfully completed an at-the-market common stock issuance. A total of 2,739,650 shares of the Company's common stock were sold at a weighted average price of $18.25, representing gross proceeds to the Company of approximately $50.0 million. Net proceeds from the transaction, after the sales commission and other expenses, were approximately $48.7 million.

On July 1, 2016, the Company completed its acquisition of Harmony Bank, a bank located in Ocean County, New Jersey. Lakeland Bancorp issued an aggregate of 3,201,109 shares of its common stock in the merger. Outstanding Harmony stock options were paid out in cash at the difference between $14.31 (Lakeland's closing stock price on July 1, 2016 of $11.45 multiplied by 1.25) and the average strike price of $9.07 for a total cash payment of $869,000.

On January 7, 2016, the Company completed its acquisition of Pascack Bancorp, Inc. ("Pascack"), a bank holding company headquartered in Waldwick, New Jersey. Lakeland Bancorp issued 3,314,284 shares of its common stock in the merger and paid approximately $4.5 million in cash, including the cash paid in connection with the cancellation of Pascack stock options. Outstanding Pascack stock options were paid out in cash at the difference between $11.35 and an average strike price of $7.37 for a total cash payment of $122,000.

NOTE 10 - INCOME TAXES

The components of income taxes are as follows:

	Years Ended December 31,		
	2018	2017	2016
	(in thousands)		
Current tax provision	$30,459	$10,565	$22,308
Deferred tax expense (benefit)	(13,571)	16,904	(987)
Total provision for income taxes	$16,888	$27,469	$21,321

In July 2018, the State of New Jersey enacted changes to the tax law that were retroactive to the beginning of 2018. Included in these changes was a surcharge in addition to the corporate tax. The surcharge will be 2.5% for 2018 and 2019, 1.5% for 2020 and 2021, and will revert to no surcharge in 2022. In addition to the surcharge, New Jersey adopted the concept of combined (consolidated) tax filings under a unitary concept for corporations that are part of an affiliated group beginning in 2019. As of July 1, 2018, the Company revalued its deferred tax assets based on the additional surcharge and the combined tax filings. Based on this revaluation, the Company recorded an increase in its net deferred tax asset of $943,000 to reflect the change in the state tax rates among its subsidiaries.

The Tax Cuts and Jobs Act was enacted on December 22, 2017, resulting in changes in the U.S. corporate tax rates, business-related exclusions, deductions and credits. Enactment of the Tax Cuts and Jobs Act requires the Company to reflect the changes associated with the law's provisions in its consolidated financial statements as of and for the year ended December 31, 2017. The Company recorded an increase in its net deferred tax asset of $1.3 million to reflect the reduction in the federal corporate income tax rate from 35% to 21%.

During 2017, the Company implemented a tax planning strategy which resulted in an increase in deferred tax liabilities, a higher deferred tax provision and a $1.9 million excise tax recorded through current tax expense.

Consequently, as a result of the Tax Cuts and Jobs Act being passed and the effect of the tax planning strategy, the net impact on the financial statements was $602,000 in additional tax expense.

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The income tax provision reconciled to the income taxes that would have been computed at the statutory federal rate of 21% for 2018 and 35% for both 2017 and 2016 is as follows:

	Years Ended December 31,		
	2018	2017	2016
	(in thousands)		
Federal income tax, at statutory rates	$16,861	$28,017	$21,994
Increase (deduction) in taxes resulting from:			
Tax-exempt income	(1,096)	(1,652)	(1,671)
Excise tax on real estate investment trust ("REIT") dividend	—	1,945	—
Adjustment to net deferred tax asset for Tax Cuts and Jobs Act	—	(1,343)	—
State income tax, net of federal income tax effect	1,880	931	552
Adjustment to net deferred tax asset for change in NJ tax law	(943)	—	—
Excess tax benefits from employee share-based payments	(318)	(587)	—
Other, net	504	158	446
Provision for income taxes	$16,888	$27,469	$21,321

The net deferred tax asset consisted of the following:

	December 31,	
	2018	2017
Deferred tax assets:	(in thousands)	
Allowance for loan and lease losses	$ 11,651	$ 10,662
Stock based compensation plans	865	769
Purchase accounting fair market value adjustments	1,192	1,441
Non-accrued interest	256	394
Deferred compensation	2,142	2,007
Depreciation and amortization	630	805
Other-than-temporary impairment loss on investment securities	59	77
Unrealized losses on securities available for sale	3,162	1,108
Other, net	585	675
Gross deferred tax assets	20,542	17,938
Deferred tax liabilities:		
Core deposit intangible from acquired companies	516	664
Undistributed income from subsidiary not consolidated for tax return purposes (REIT)	149	12,015
Deferred loan costs	1,418	1,169
Prepaid expenses	459	524
Deferred gain on securities	166	116
Unfunded pension benefits	17	7
Loss on equity securities	36	—

Unrealized gains on hedging derivative	322	229
Other	270	357
Gross deferred tax liabilities	3,353	15,081
Net deferred tax assets	$ 17,189	$ 2,857

The Company evaluates the realizability of its deferred tax assets by examining its earnings history and projected future earnings and by assessing whether it is more likely than not that carryforwards would not be realized. Based upon the majority of the Company’s deferred tax assets having no expiration date, the Company’s earnings history, and the projections of future earnings, the Company’s management believes that it is more likely than not that all of the Company’s deferred tax assets as of December 31, 2018 will be realized.

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The Company evaluates tax positions that may be uncertain using a recognition threshold of more likely than not, and a measurement attribute for all tax positions taken or expected to be taken on a tax return, in order for those tax positions to be recognized in the financial statements. The Company had no unrecognized tax benefits or related interest or penalties at December 31, 2018 or 2017.

The Company is subject to U.S. federal income tax law as well as income tax of various state jurisdictions. Tax regulations within each jurisdiction are subject to the interpretation of the related tax laws and regulations and require significant judgment to apply. With few significant exceptions, the Company is no longer subject to U.S. federal examinations by tax authorities for the years before 2016 or to state and local examinations by tax authorities for the years before 2015.

NOTE 11 - EMPLOYEE BENEFIT PLANS

Profit Sharing Plan

The Company has a profit sharing plan for all its eligible employees. The Company’s discretionary annual contribution to the plan is determined by its Board of Directors. Annual contributions are allocated to participants on a point basis with accumulated benefits payable at retirement, or, at the discretion of the plan committee, upon termination of employment. There were no contributions made by the Company in 2018 or 2017, while contributions made by the Company totaled $600,000 for the year ended 2016.

Benefit Obligations from Somerset Hills Acquisition

Somerset Hills, acquired by the Company in 2013, entered into a non-qualified Supplemental Executive Retirement Plan (“SERP”) with its former Chief Executive Officer and its Chief Financial Officer which entitles them to a benefit of $48,000 and $24,000, respectively, per year for 15 years after the earlier of retirement or death. The former Chief Executive Officer and the beneficiary of the Chief Financial Officer are currently being paid out under the plan. As of December 31, 2018 and 2017, the Company had a liability of $629,000 and $702,000, respectively, for these SERPs and recognized an expense of $(1,000), $33,000 and $0 in 2018, 2017 and 2016, respectively.

401(k) plan

The Company has a 401(k) plan covering substantially all employees providing they meet eligibility requirements. The Company matches 50% of the first 6% contributed by the participants to the 401(k) plan. The Company’s contributions in 2018, 2017 and 2016 totaled $1.1 million, $1.0 million and $911,000, respectively.

Supplemental Executive Retirement Plans

In December 2003, the Company entered into a SERP agreement with its former CEO that provides annual retirement benefits of $150,000 a year for a 15 year period when the former CEO reached the age of 65. Our former CEO retired and is receiving annual retirement benefits pursuant to the plan. In 2008, the Company entered into a SERP agreement with its current CEO that provides annual retirement benefits of $150,000 for a 15 year period when the CEO reaches the age of 65. In November 2008, the Company entered into a SERP with a Regional President that provides annual retirement benefits of $90,000 a year for a 10 year period upon his reaching the age of 65. In December 2016, the Company entered into a SERP with a former Regional President that provides $84,500 a year for a 15 year period upon his reaching the age of 66. The Company intends to fund its obligations under the deferred compensation arrangements with the increase in cash surrender value of bank owned life insurance policies. In 2018, 2017 and 2016, the Company recorded compensation expense of $83,000, $261,000 and $746,000, respectively, for these plans. The accrued liability for these plans was $3.3 million and $3.5 million for the years ended December 31, 2018 and 2017, respectively.

Deferred Compensation Agreement

In February 2015, the Company entered into a Deferred Compensation Agreement with its CEO where it would contribute $16,500 monthly into a deferral account which would earn interest at an annual rate of the Company’s prior year return on equity, provided that the Company’s return on equity remained in a range of 0% to 15%. The Company has agreed to make such contributions each month that the CEO is actively employed from February 2015 through December 31, 2022. The expense incurred in 2018, 2017 and 2016 was $269,000, $244,000 and $222,000, respectively, and the accrued liability at December 31, 2018 and 2017 was $923,000 and $654,000, respectively. Following the CEO’s normal retirement date, he shall be paid out in 180 consecutive monthly installments.

Elective Deferral Plan

In March 2015, the Company established an Elective Deferral Plan for eligible executives in which the executive may elect to contribute a portion of his base salary and bonus to a deferral account which will earn an interest rate of 75% of the Company’s prior year return on equity provided that the return on equity remains in the range of 0% to 15%. The Company recorded an expense of $73,000, $55,000 and $22,000 in 2018, 2017 and 2016, respectively, and had a liability recorded of $1.4 million and $916,000 at December 31, 2018 and 2017, respectively.

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NOTE 12 - DIRECTORS RETIREMENT PLAN

The Company provides a retirement plan that directors appointed to the board prior to 2009 who completed five years of service may retire and receive benefit payments ranging from $5,000 through $17,500 per annum, depending upon years of credited service, for a period of ten years. This plan is unfunded. The following tables present the status of the plan and the components of net periodic plan cost for the years then ended. The measurement date for the accumulated benefit obligation is December 31 of the years presented.

	December 31, 2018 (in thousands)	2017
Accrued plan cost included in other liabilities	$ 604	$ 673
Amount not recognized as component of net postretirement benefit cost		
Recognized in accumulated other comprehensive income		
Net actuarial gain	$ (29)	$ 28
Unrecognized prior service cost	—	—
Amounts not recognized as a component of net postretirement benefit (benefit)	$ (29)	$ 28

	Years Ended December 31, 2018	2017	2016
	(in thousands)		
Net periodic plan cost included the following components:			
Service cost	$ 15	$ 21	$ 19
Interest cost	20	23	26
Amortization of prior service cost	—	3	12
	$ 35	$ 47	$ 57

A discount rate of 3.97%, 3.30% and 3.68% was assumed in the plan valuation for 2018, 2017 and 2016, respectively. As the benefit amount is not dependent upon compensation levels, a rate of increase in compensation assumption was not utilized in the plan valuation.

The directors' retirement plan holds no plan assets. The benefits expected to be paid in each of the next five years and in aggregate for the five years thereafter are as follows (in thousands):

2019	$ 57
2020	63
2021	37
2022	38
2023	38

2024-2028 235

The Company expects its contribution to the directors' retirement plan to be $57,000 in 2019.

There is no expected amount to be recognized in accumulated other comprehensive income as a component of net periodic benefit cost in 2019.

NOTE 13 - STOCK-BASED COMPENSATION

Employee Stock Option Plans

The Company's shareholders approved the 2018 Omnibus Equity Incentive Plan (the "Plan"), which authorizes the granting of incentive stock options, supplemental stock options, stock appreciation rights, restricted shares, restricted stock units, other stock-based awards and cash-based awards to officers, employees and non-employee directors of, and consultants and advisors to, the Company and its subsidiaries. The Plan authorizes the issuance of up to 2.0 million shares of Company common stock and includes approximately 1.1 million shares of common stock theretofore available under the Company's 2009 Equity Compensation Program but not used. The maximum term of the Company’s stock option grants under the Plan is ten years from the date of grant.

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Under the 2009 Equity Compensation Program, 2.3 million shares of common stock of the Company were authorized. The maximum term of the Company's stock option grants under this plan was ten years from the date of grant. In 2014, the Company began issuing restricted stock units ("RSUs"), some of which have performance conditions attached to them. No further awards may be granted from the 2009 program.

The Company has outstanding stock options issued to its directors as well as options assumed under the Somerset Hills' stock option plans at the time of the Company's acquisition of Somerset Hills. As of December 31, 2018 and 2017, respectively, 55,192 and 81,442 options granted to directors were outstanding. As of December 31, 2018 and 2017, there were 12,296 and 20,774 options outstanding, respectively, under the Somerset Hills' stock option plans.

Excess tax benefits of stock based compensation were $318,000, $587,000 and $43,000 for the years 2018, 2017 and 2016, respectively.

A summary of the status of the Company's option plans as of December 31, 2018 and the changes during the year ending on that date is represented below.

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in Years)	Aggregate Intrinsic Value
Outstanding, beginning of year	102,216	$ 8.49	4.27	$1,101,806
Granted	—	—		
Exercised	(34,728)	8.84		
Expired	—	—		
Forfeited	—	—		
Outstanding, end of year	67,488	$ 8.28	2.86	$440,483
Options exercisable at year-end	67,488	$ 8.28	2.86	$440,483

There were no non-vested options under the Company's option plans as of December 31, 2018 and no changes to the non-vested options for the year then ended.

As of December 31, 2018, there was no unrecognized compensation expense related to unvested stock options under the 2018 Omnibus Equity Incentive Plan or the 2009 Equity Compensation Program. Compensation expense recognized for stock options was $0, $14,000 and $35,000 for 2018, 2017 and 2016, respectively.

The aggregate intrinsic values of options exercised in 2018 and 2017 were $406,000 and $337,000, respectively. Exercise of stock options during 2018 and 2017 resulted in cash receipts of $307,000 and $321,000, respectively. The total fair value of options that vested in 2018 and 2017 were $0 and $35,000, respectively.

Information regarding the Company's restricted stock for the year ended December 31, 2018 is as follows:

	Number of Shares	Weighted Average Price
Outstanding, Balance at of January 1, 2018	22,982	$ 14.44
Granted	11,575	20.30
Vested	(22,856)	14.46
Outstanding, December 31, 2018	11,701	$ 20.18

In 2018, the Company granted 11,575 shares of restricted stock to non-employee directors at a grant date fair value of $20.30 per share under the Company's 2018 Omnibus Equity Incentive Plan and 2009 Equity Compensation Program. These shares will vest over a one year period, totaling $235,000 in compensation expense. In 2017, the Company granted 13,176 shares of restricted stock to non-employee directors at a grant date fair value of $18.20 per share under the Company's 2009 Equity Compensation Program. These shares vested over a one year period, totaling $240,000 in compensation expense. In 2016, the Company granted 23,952 shares of restricted stock to non-employee directors at a grant date fair value of $10.02 per share under the Company's 2009 Equity Compensation Program. These shares vested over a one year period, totaling $240,000 in compensation expense.

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The total fair value of the restricted stock vested during the year ended December 31, 2018 was approximately $331,000. Compensation expense recognized for restricted stock was $237,000, $287,000 and $353,000 in 2018, 2017 and 2016, respectively. There was approximately $3,000 in unrecognized compensation expense related to restricted stock grants as of December 31, 2018, which is expected to be recognized over a period of 0.05 years.

In 2018, the Company granted 159,233 RSUs at a weighted average grant date fair value of $19.09 per share under the Company's 2018 Omnibus Equity Incentive Plan and 2009 Equity Compensation Program. These units vest within a range of two to three years. A portion of these RSUs will vest subject to certain performance conditions in the restricted stock unit agreements. There are also certain provisions in the compensation program which state that if a holder of the RSUs reaches a certain age and years of service, the person has effectively earned a portion of the RSUs at that time. Compensation expense on the RSUs granted in 2018 is expected to average approximately $1.0 million per year over a three year period. In 2017, the Company granted 132,523 RSUs at a weighted average grant date fair value of $19.92 per share under the Company's 2009 Equity Compensation Program. These units vest within a range of two to three years. Compensation expense on these restricted stock units is expected to average approximately $880,000 per year over a three year period. In 2016, the Company granted 180,926 RSUs at a weighted average grant date fair value of $10.45 per share under the Company's 2009 Equity Compensation Program. Compensation expense on these restricted stock units is expected to average $630,000 per year over a three year period. Compensation expense for restricted stock units totaled $2.2 million, $2.0 million and $1.5 million in 2018, 2017 and 2016, respectively. There was approximately $2.5 million in unrecognized compensation expense related to restricted stock units as of December 31, 2018, which is expected to be recognized over a period of 1.20 years.

Information regarding the Company's RSUs and changes during the year ended December 31, 2018 is as follows:

	Number of RSUs	Weighted Average Price
Outstanding, Balance at of January 1, 2018	267,732	$ 13.93
Granted	159,233	19.09
Vested	(119,421)	13.76
Forfeited	(8,197)	18.99
Outstanding, December 31, 2018	299,347	$ 16.60

NOTE 14 - REVENUE RECOGNITION

The Company's primary source of revenue is interest income generated from loans, leases and investment securities. Interest income is recognized according to the terms of the financial instrument agreement over the life of the loan, lease or investment security unless it is determined that the counterparty is unable to continue making interest payments. Interest income also includes prepaid interest fees from commercial customers, which approximates the interest foregone on the balance of the loan prepaid.

The Company's additional source of income, also referred to as noninterest income, is generated from deposit related fees, interchange fees, loan and lease fees, merchant fees, loan sales and other miscellaneous income and is largely based on contracts with customers. In these cases, the Company recognizes revenue when it satisfies a performance obligation by transferring control over a product or service to a customer. The Company considers a customer to be any party to which the Company will provide goods or services that are an output of the Company's ordinary activities in exchange for consideration. There is little seasonality with regards to revenue from contracts with customers and all inter-company revenue is eliminated when the Company's financial statements are consolidated.

Generally, the Company enters into contracts with customers that are short-term in nature where the performance obligations are fulfilled and payment is processed at the same time. Such examples include revenue related to merchant fees, interchange fees and investment services income. In addition, revenue generated from existing customer relationships such as deposit accounts are also considered short-term in nature, because the relationship may be terminated at any time and payment is processed at the time performance obligations are fulfilled. As a result, the Company does not have contract assets, contract liabilities or related receivable accounts for contracts with customers. In cases where collectability is a concern, the Company does not record revenue.

Generally, the pricing of transactions between the Company and each customer is either (i) established within a legally enforceable contract between the two parties, as is the case with the loan sales, or (ii) disclosed to the customer at a specific point in time, as is the case when a deposit account is opened or before a new loan is underwritten. Fees are usually fixed at a specific amount or as a percentage of a transaction amount. No judgment or estimates by management are required to record revenue related to these transactions and pricing is clearly identified within these contracts.

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The Company primarily operates in one geographic region, Northern and Central New Jersey and contiguous areas. Therefore, all significant operating decisions are based upon analysis of the Company as one operating segment or unit.

We disaggregate our revenue from contracts with customers by contract-type and timing of revenue recognition, as we believe it best depicts how the nature, amount, timing and uncertainty of our revenue and cash flows are affected by economic factors. Noninterest income not generated from customers during the Company’s ordinary activities primarily relates to mortgage servicing rights, gains/losses on the sale of investment securities, gains/losses on the sale of other real estate owned, gains/losses on the sale of property, plant and equipment, and income from bank owned life insurance.

The following table sets forth the components of noninterest income for the years ended December 31, 2018, 2017 and 2016:

	2018	2017	2016
	(in thousands)		
Deposit Related Fees and Charges			
Debit card interchange income	$5,150	$4,474	$4,086
Overdraft charges	3,938	4,656	4,763
ATM service charges	830	808	705
Demand deposit fees and charges	540	679	546
Savings service charges	126	123	57
Total	10,584	10,740	10,157
Commissions and Fees			
Loan and lease fees	1,264	1,136	1,198
Wire transfer charges	1,093	1,005	914
Investment services income	1,314	1,045	973
Merchant fees	784	718	444
Commissions from sales of checks	434	457	448
Safe deposit income	371	269	247
Other income	264	202	96
Total	5,524	4,832	4,320
Gains on Sale of Loans	1,329	1,836	2,123
Other Income			
Gains on customer swap transactions	1,992	982	1,056
Title insurance income	195	200	142
Other income	295	518	431
Total	2,482	1,700	1,629
Revenue not from contracts with customers	2,391	6,327	3,101
Total Noninterest Income	$22,310	$25,435	$21,330
Timing of Revenue Recognition			
Products and services transferred at a point in time	$19,844	$19,040	$18,192
Products and services transferred over time	75	68	37
Revenue not from contracts with customers	2,391	6,327	3,101
Total Noninterest Income	$22,310	$25,435	$21,330

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NOTE 15 - COMMITMENTS AND CONTINGENCIES

Lease Obligations

Lakeland is obligated under various non-cancelable operating leases on building and land used for office space and banking purposes. These leases contain renewal options and escalation clauses. Rent expense under long-term operating leases amounted to approximately $3.0 million, $3.1 million and $3.2 million for the years ended December 31, 2018, 2017 and 2016, respectively, including rent expense to related parties of $144,000 in 2018, $144,000 in 2017, and $141,000 in 2016. At December 31, 2018, the minimum commitments under all noncancellable leases with remaining terms of more than one year and expiring through 2033 are as follows (in thousands):

Year	
2019	$3,191
2020	3,055
2021	2,866
2022	2,572
2023	2,233
Thereafter	14,642
	$28,559

Litigation

There are no pending legal proceedings involving the Company or Lakeland other than those arising in the normal course of business. Management does not anticipate that the potential liability, if any, arising out of such legal proceedings will have a material effect on the financial condition or results of operations of the Company and Lakeland on a consolidated basis.

NOTE 16 - FINANCIAL INSTRUMENTS WITH OFF-BALANCE-SHEET RISK AND CONCENTRATIONS OF CREDIT RISK

Lakeland is party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit and standby letters of credit. Such financial instruments are recorded in the consolidated financial statements when they become payable. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheets. The contract or notional amounts of those instruments reflect the extent of involvement Lakeland has in particular classes of financial instruments.

Lakeland's exposure to credit loss in the event of non-performance by the other party to the financial instrument for commitments to extend credit and standby letters of credit is represented by the contractual or notional amount of those instruments. Lakeland uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

Lakeland generally requires collateral or other security to support financial instruments with credit risk. The approximate contract amounts are as follows:

	December 31,	
	2018	2017
	(in thousands)	
Financial instruments whose contract amounts represent credit risk		
Commitments to extend credit	$973,709	$966,441
Standby letters of credit and financial guarantees written	21,585	14,832

At December 31, 2018 and 2017 there were $808,000 and $20,000, respectively, in commitments to lend additional funds to borrowers whose terms have been modified in troubled debt restructurings.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. Lakeland evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained, if deemed necessary by Lakeland upon extension of credit, is based on management's credit evaluation.

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Standby letters of credit are conditional commitments issued by Lakeland to guarantee the payment by or performance of a customer to a third party. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Lakeland holds deposit accounts, residential or commercial real estate, accounts receivable, inventory and equipment as collateral to support those commitments for which collateral is deemed necessary. The extent of collateral held for those commitments at December 31, 2018 and 2017 varies based on management's credit evaluation.

Lakeland issues financial and performance letters of credit. Financial letters of credit require Lakeland to make payment if the customer fails to make payment, as defined in the agreements. Performance letters of credit require Lakeland to make payments if the customer fails to perform certain non-financial contractual obligations. Lakeland defines the initial fair value of these letters of credit as the fees received from the customer. Lakeland records these fees as a liability when issuing the letters of credit and amortizes the fee over the life of the letter of credit.

The maximum potential undiscounted amount of future payments of these letters of credit as of December 31, 2018 was $21.6 million and they expire through 2024. Lakeland's exposure under these letters of credit would be reduced by actual performance, subsequent termination by the beneficiaries and by any proceeds that Lakeland obtained in liquidating the collateral for the loans, which varies depending on the customer.

As of December 31, 2018, Lakeland had $973.7 million in loan and lease commitments, with $667.9 million maturing within one year, $135.5 million maturing after one year but within three years, $19.1 million maturing after three years but within five years, and $151.2 million maturing after five years. As of December 31, 2018, Lakeland had $21.6 million in standby letters of credit, with $21.1 million maturing within one year, $444,000 maturing after one year but within three years, $0 maturing after three years but within five years and $80,000 maturing after five years.

Lakeland grants loans primarily to customers in New Jersey, the Hudson Valley Region in New York State, and surrounding areas. Certain of Lakeland's consumer loans and lease customers are more diversified nationally. Although Lakeland has a diversified loan portfolio, a large portion of its loans are secured by commercial or residential real property. Although Lakeland has a diversified loan portfolio, a substantial portion of its debtors' ability to honor their contracts is dependent upon the economy. Commercial and standby letters of credit were granted primarily to commercial borrowers.

NOTE 17 - COMPREHENSIVE INCOME (LOSS)

The Company reports comprehensive income (loss) in addition to net income (loss) from operations. Comprehensive income is a more inclusive financial reporting methodology that includes disclosure of certain financial information that historically has not been recognized in the calculation of net income.

The following table shows the changes in the balances of each of the components of other comprehensive income for the periods presented.

	Year Ended December 31, 2018		
	Before Tax Amount	Tax Benefit (Expense)	Net of Tax Amount
	(in thousands)		
Unrealized losses on securities available for sale			
Unrealized holding losses arising during period	$(4,241)	$ 734	$ (3,507)
Reclassification adjustment for securities gains included in net income	—	—	—
Net unrealized losses on securities available for sale	(4,241)	734	(3,507)
Unrealized gains on derivatives	9	32	41
Change in pension liability, net	29	(9)	20
Other comprehensive loss	$(4,203)	$ 757	$ (3,446)

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	Year Ended December 31, 2017		
	Before Tax Amount	Tax Benefit (Expense)	Net of Tax Amount
	(in thousands)		
Unrealized losses on securities available for sale			
Unrealized holding losses arising during period	$(1,406)	$ 503	$ (903)
Reclassification adjustment for securities gains included in net income	(2,524)	884	(1,640)
Net unrealized losses on securities available for sale	(3,930)	1,387	(2,543)
Unrealized gains on derivatives	57	(20)	37
Change in pension liability, net	(27)	11	(16)
Other comprehensive loss	$(3,900)	$ 1,378	$ (2,522)

	Year Ended December 31, 2016		
	Before Tax Amount	Tax Benefit (Expense)	Net of Tax Amount
	(in thousands)		
Unrealized losses on securities available for sale			
Unrealized holding losses arising during period	$(1,816)	$ 778	$ (1,038)
Reclassification adjustment for securities gains included in net income	(370)	137	(233)
Net unrealized losses on available for sale securities	(2,186)	915	(1,271)
Unrealized gains on derivatives	1,033	(361)	672
Change in pension liability, net	70	(28)	42
Other comprehensive loss	$(1,083)	$ 526	$ (557)

	Unrealized Gains (Losses) on Available-for-Sale Securities	Unrealized Gains (Losses) on Derivatives	Pension Items	Total
	(in thousands, net of tax)			
Balance at of January 1, 2016	$1,154	$ —	$ (4)	$1,150
Other comprehensive income (loss) before classifications	(1,038)	672	42	(324)
Amounts reclassified from accumulated other comprehensive income	(233)	$ —	—	(233)
Net current period other comprehensive income (loss)	(1,271)	672	42	$(557)
Balance at December 31, 2016	$(117)	$ 672	$ 38	$593
Other comprehensive income (loss) before classifications	(903)	37	(16)	(882)
Amounts reclassified from accumulated other comprehensive income	(1,640)	—	—	(1,640)
Net current period other comprehensive income (loss)	(2,543)	37	(16)	(2,522)
Adjustment for implementation of ASU 2018-02	(572)	153	(1)	(420)
Balance at December 31, 2017	$(3,232)	$ 862	$ 21	$(2,349)
Adjustment for implementation of ASU 2016-01	(2,043)	—	—	(2,043)
Adjusted balance as of January 1, 2018	(5,275)	862	21	(4,392)
Other comprehensive income (loss) before classifications	(3,507)	41	20	(3,446)
Amounts reclassified from accumulated other comprehensive income	—	—	—	—
Net current period other comprehensive income (loss)	(3,507)	41	20	(3,446)
Balance at December 31, 2018	$(8,782)	$ 903	$ 41	$(7,838)

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NOTE 18 - FAIR VALUE MEASUREMENT AND FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair Value Measurement

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market for an asset or liability in an orderly transaction between market participants at the measurement date. U.S. GAAP establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels giving the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest level priority to unobservable inputs (level 3 measurements). The following describes the three levels of fair value hierarchy:

Level 1 - unadjusted quoted prices in active markets for identical assets or liabilities; includes U.S. Treasury Notes, and other U.S. Government Agency securities that actively trade in over-the-counter markets; equity securities and mutual funds that actively trade in over-the-counter markets.

Level 2 - quoted prices for similar assets or liabilities in active markets; or quoted prices for identical or similar assets or liabilities in markets that are not active; or inputs other than quoted prices that are observable for the asset or liability including yield curves, volatilities, and prepayment speeds.

Level 3 - unobservable inputs for the asset or liability that reflect the Company's own assumptions about assumptions that market participants would use in the pricing of the asset or liability and that are consequently not based on market activity but on particular valuation techniques.

The Company's assets that are measured at fair value on a recurring basis are its available for sale investment securities and its interest rate swaps. The Company obtains fair values on its securities using information from a third party servicer. If quoted prices for securities are available in an active market, those securities are classified as Level 1 securities. The Company has U.S. Treasury Notes and certain equity securities that are classified as Level 1 securities. Level 2 securities were primarily comprised of U.S. Agency bonds, residential mortgage-backed securities, obligations of state and political subdivisions and corporate securities. Fair values were estimated primarily by obtaining quoted prices for similar assets in active markets or through the use of pricing models supported with market data information. Standard inputs include benchmark yields, reported trades, broker-dealer quotes, issuer spreads, bids and offers. On a quarterly basis, the Company reviews the pricing information received from the Company's third party pricing service. This review includes a comparison to non-binding third-party quotes.

The fair values of derivatives are based on valuation models using current market terms (including interest rates and fees), the remaining terms of the agreements and the credit worthiness of the counter-party as of the measurement date (Level 2).

The following table sets forth the Company's financial assets that were accounted for at fair value on a recurring basis as of the periods presented by level within the fair value hierarchy. During the years ended December 31, 2018 and 2017, the Company did not make any transfers between recurring Level 1 fair value measurements and recurring Level 2 fair value measurements. Financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement:

December 31, 2018	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Fair Value
	(in thousands)			
Assets:				
Investment securities, available for sale				
U.S. Treasury and government agencies	$4,920	$ 136,007	$ —	$140,927
Mortgage-backed securities	—	447,094	—	447,094
Obligations of states and political subdivisions	—	45,505	—	45,505
Corporate debt securities	—	5,092	—	5,092

Total securities available for sale	4,920	633,698	—	638,618
Equity securities, at fair value	2,731	13,190	—	15,921
Derivative assets	—	12,135	—	12,135
Total Assets	$7,651	$ 659,023	$ —	$666,674
Liabilities:				
Derivative liabilities	$—	$ 11,036	$ —	$11,036
Total Liabilities	$—	$ 11,036	$ —	$11,036

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December 31, 2017	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Fair Value
	(in thousands)			
Assets:				
Investment securities, available for sale				
U.S. Treasury and government agencies	$5,415	$ 141,840	$ —	$147,255
Mortgage-backed securities	—	424,331	—	424,331
Obligations of states and political subdivisions	—	51,320	—	51,320
Corporate debt securities	—	5,140	—	5,140
Total securities available for sale	5,415	622,631	—	628,046
Equity securities, at fair value	5,147	12,942	—	18,089
Derivative assets	—	6,555	—	6,555
Total Assets	$10,562	$ 642,128	$ —	$652,690
Liabilities:				
Derivative liabilities	$—	$ 5,465	$ —	$5,465
Total Liabilities	$—	$ 5,465	$ —	$5,465

The following table sets forth the Company's financial assets subject to fair value adjustments (impairment) on a non-recurring basis. Assets are classified in their entirety based on the lowest level of input that is significant to the fair value measurement:

December 31, 2018	(Level 1)	(Level 2)	(Level 3)	Total Fair Value
	(in thousands)			
Assets:				
Impaired loans and leases	$—	$ —	$ 19,702	$ 19,702
Loans held for sale	—	1,113	—	1,113
Other real estate owned and other repossessed assets	—	—	830	830

December 31, 2017	(Level 1)	(Level 2)	(Level 3)	Total Fair Value
	(in thousands)			
Assets:				
Impaired loans and leases	$—	$ —	$ 22,591	$ 22,591
Loans held for sale	—	456	—	456
Other real estate owned and other repossessed assets	—	—	843	843

Impaired loans and leases are evaluated and valued at the time the loan is identified as impaired at the lower of cost or market value. Because most of Lakeland's impaired loans are collateral dependent, fair value is generally measured based on the value of the collateral, less estimated costs to sell, securing these loans and leases and is classified at a level 3 in the fair value hierarchy. Collateral may be real estate, accounts receivable, inventory, equipment and/or other business assets. The value of the real estate is assessed based on appraisals by qualified third party licensed appraisers. The appraisers may use the income approach to value the collateral using discount rates (with ranges of 5-11%) or capitalization rates (with ranges of 4-9%) to evaluate the property. The value of the equipment may be determined by an appraiser, if significant, inquiry through a recognized valuation resource, or by the value on the borrower's financial statements. Field examiner reviews on business assets may be conducted based on the loan exposure and reliance on this type of collateral. Appraised and reported values may be discounted based on management's historical knowledge, changes in market conditions from the time of valuation, and/or management's expertise and knowledge of the client and client’s business. Impaired loans and leases are reviewed and evaluated on at least a quarterly basis for additional impairment and adjusted accordingly, based on the same factors identified above. The Company has a held for sale loan portfolio that consists of residential mortgages that are being sold in the secondary market. The Company records these mortgages at the lower of cost or fair market value. Fair value is generally determined by the value of purchase commitments.

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Other real estate owned (OREO) and other repossessed assets, representing property acquired through foreclosure or deed in lieu of foreclosure, are carried at fair value less estimated disposal costs of the acquired property. Fair value on other real estate owned is based on the appraised value of the collateral using discount rates or capitalization rates similar to those used in impaired loan valuation. The fair value of other repossessed assets is estimated by inquiry through a recognized valuation resource.

Changes in the assumptions or methodologies used to estimate fair values may materially affect the estimated amounts. Changes in economic conditions, locally or nationally, could impact the value of the estimated amounts of impaired loans, OREO and other repossessed assets.

Fair Value of Certain Financial Instruments

Estimated fair values have been determined by the Company using the best available data and an estimation methodology suitable for each category of financial instruments. Management is concerned that there may not be reasonable comparability between institutions due to the wide range of permitted assumptions and methodologies in the absence of active markets. This lack of uniformity gives rise to a high degree of subjectivity in estimating financial instrument fair values.

The estimation methodologies used, the estimated fair values, and recorded book balances at December 31, 2018 and December 31, 2017 are outlined below.

This summary, as well as the table below, excludes financial assets and liabilities for which carrying value approximates fair value. For financial assets, these include cash and cash equivalents. For financial liabilities, these include noninterest-bearing demand deposits, savings and interest-bearing transaction accounts and federal funds sold and securities sold under agreements to repurchase. The estimated fair value of demand, savings and interest-bearing transaction accounts is the amount payable on demand at the reporting date. Carrying value is used because there is no stated maturity on these accounts, and the customer has the ability to withdraw the funds immediately. Also excluded from this summary and the following table are those financial instruments recorded at fair value on a recurring basis, as previously described.

The fair value of investment securities held to maturity was measured using information from the same third-party servicer used for investment securities available for sale using the same methodologies discussed above. Investment securities held to maturity includes $6.0 million in short-term municipal bond anticipation notes and $1.0 million in subordinated debt that are non-rated and do not have an active secondary market or information readily available on standard financial systems. As a result, the securities are classified as Level 3 securities. Management performs a credit analysis before investing in these securities.

FHLB stock is an equity interest that can be sold to the issuing FHLB, to other FHLBs, or to other member banks at its par value. Because ownership of these securities is restricted, they do not have a readily determinable fair value. As such, the Company’s FHLB stock is recorded at cost or par value and is evaluated for impairment each reporting period by considering the ultimate recoverability of the investment rather than temporary declines in value. The Company’s evaluation primarily includes an evaluation of liquidity, capitalization, operating performance, commitments, and regulatory or legislative events.

The net loan portfolio at December 31, 2018 has been valued using an exit price approach, which incorporates a build-up discount rate calculation that uses a swap rate adjusted for credit risk, servicing costs, a liquidity premium and a prepayment premium. This is not comparable with the fair values used for December 31, 2017, which are based on entrance prices. For December 31, 2017, the loan portfolio was valued using a present value discounted cash flow where market prices are not available. The discount rate used in these calculations is the estimated current market rate adjusted for credit risk.

For fixed maturity certificates of deposit, fair value was estimated based on the present value of discounted cash flows using the rates currently offered for deposits of similar remaining maturities. The carrying amount of accrued interest payable approximates its fair value.

The fair value of long-term debt is based upon the discounted value of contractual cash flows. The Company estimates the discount rate using the rates currently offered for similar borrowing arrangements. The fair value of subordinated debentures is based on bid/ask prices from brokers for similar types of instruments.

The fair values of commitments to extend credit and standby letters of credit are estimated using the fees currently charged to enter into similar agreements, taking into account the remaining terms of the agreements and the present creditworthiness of the counterparties. For fixed-rate loan commitments, fair value also considers the difference between current levels of interest rates and the committed rates. The fair value of guarantees and letters of credit is based on fees currently charged for similar agreements or on the estimated cost to terminate them or otherwise settle the obligations with the counterparties at the reporting date. The fair values of commitments to extend credit and standby letters of credit are deemed immaterial.

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The following table presents the carrying values, fair values and placement in the fair value hierarchy of the Company's financial instruments as of December 31, 2018 and December 31, 2017:

December 31, 2018	Carrying Value	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	(in thousands)				
Financial Assets:					
Investment securities held to maturity	$153,646	$150,932	$ —	$ 143,913	$ 7,019
Federal Home Loan and other membership bank stock	13,301	13,301	—	13,301	—
Loans and leases, net	4,419,045	4,341,477	—	—	4,341,477
Financial Liabilities:					
Certificates of deposit	757,038	750,801	—	750,801	—
Other borrowings	181,118	176,921	—	176,921	—
Subordinated debentures	105,027	102,497	—	—	102,497

December 31, 2017	Carrying Value	Fair Value	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	(in thousands)				
Financial Assets:					
Investment securities held to maturity	$139,685	$138,688	$ —	$ 127,901	$ 10,787
Federal Home Loan and other membership bank stock	12,576	12,576	—	12,576	—
Loans and leases, net	4,117,265	4,114,516	—	—	4,114,516
Financial Liabilities:					
Certificates of deposit	737,428	732,417	—	732,417	—
Other borrowings	192,011	189,080	—	189,080	—
Subordinated debentures	104,902	97,244	—	—	97,244

NOTE 19 - DERIVATIVES

Lakeland is a party to interest rate derivatives that are not designated as hedging instruments. Under a program, Lakeland executes interest rate swaps with commercial lending customers to facilitate their respective risk management strategies. These interest rate swaps with customers are simultaneously offset by interest rate swaps that Lakeland executes with a third party, such that Lakeland minimizes its net risk exposure resulting from such transactions. Because the interest rate swaps associated with this program do not meet the strict hedge accounting requirements, changes in the fair value of both the customer swaps and the offsetting swaps are recognized directly in earnings. The changes in the fair value of the swaps offset each other, except for the credit risk of the counterparties, which is determined by taking into consideration the risk rating, probability of default and loss given default for all counterparties. As of December 31, 2018 and 2017, Lakeland had $498,000 and $500,000, respectively, in securities pledged for collateral on its interest rate swaps.

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In June 2016, the Company entered into two cash flow hedges in order to hedge the variable cash outflows associated with its floating rate subordinated debentures (See Note 8). The notional value of these hedges was $30.0 million. The Company's objective in using the cash flow hedge is to add stability to interest expense and to manage its exposure to interest rate movements. The Company used interest rate swaps designated as cash flow hedges which involved the receipt of variable amounts from a counterparty in exchange for the Company making fixed-rate payments over the life of the agreements without exchange of the underlying notional amount. In these particular hedges the Company is paying a third party an average of 1.10% in exchange for a payment at 3 month LIBOR. The effective portion of changes in the fair value of derivatives designated and that qualify as cash flow hedges are recorded in accumulated other comprehensive income and are subsequently reclassified into earnings in the period that the hedged forecasted transaction affects earnings. During the year ended December 31, 2018, the Company did not record any hedge ineffectiveness. The Company recognized $329,000 of accumulated other comprehensive income that was reclassified into interest expense during 2018. The Company did not enter into any hedges in 2018.

Amounts reported in accumulated other comprehensive income related to derivatives will be reclassified to interest expense as interest payments are made on the Company's debt. During the next twelve months, the Company estimates that $509,000 will be reclassified as a decrease to interest expense should the rate environment remain the same.

The following table presents summary information regarding these derivatives for the periods presented (dollars in thousands):

December 31, 2018	Notional Amount	Average Maturity (Years)	Weighted Average Rate Fixed		Weighted Average Variable Rate	Fair Value
Classified in Other Assets:						
3rd Party interest rate swaps	$153,909	8.3	4.10	%	1 Mo. LIBOR + 2.13%	$ 5,329
Customer interest rate swaps	164,427	12.0	5.04	%	1 Mo. LIBOR + 2.05%	5,707
Interest rate swap (cash flow hedge)	30,000	2.5	1.10	%	3 Mo. LIBOR	1,099
Classified in Other Liabilities:						
Customer interest rate swaps	$153,909	8.3	4.10	%	1 Mo. LIBOR + 2.13%	$ (5,329)
3rd party interest rate swaps	164,427	12.0	5.04	%	1 Mo. LIBOR + 2.05%	(5,707)

December 31, 2017	Notional Amount	Average Maturity (Years)	Weighted Average Rate Fixed		Weighted Average Variable Rate	Fair Value
Classified in Other Assets:						
3rd Party interest rate swaps	$110,076	8.8	3.87	%	1 Mo. LIBOR + 2.11%	$ 3,634
Customer interest rate swaps	82,760	11.5	4.74	%	1 Mo. LIBOR + 2.21%	1,831
Interest rate swap (cash flow hedge)	30,000	3.5	1.10	%	3 Mo. LIBOR	1,090
Classified in Other Liabilities:						
Customer interest rate swaps	$110,076	8.8	3.87	%	1 Mo. LIBOR + 2.11%	$ (3,634)
3rd party interest rate swaps	82,760	11.5	4.74	%	1 Mo. LIBOR + 2.21%	(1,831)

NOTE 20 - REGULATORY MATTERS

The Bank Holding Company Act of 1956 restricts the amount of dividends the Company can pay. Accordingly, dividends should generally only be paid out of current earnings, as defined.

The New Jersey Banking Act of 1948 restricts the amount of dividends paid on the capital stock of New Jersey chartered banks. Accordingly, no dividends shall be paid by such banks on their capital stock unless, following the payment of such dividends, the capital stock of Lakeland will be unimpaired, and: (1) Lakeland will have a surplus, as defined, of not less than 50% of its capital stock, or, if not, (2) the payment of such dividend will not reduce the surplus, as defined, of Lakeland. Under these limitations, approximately $544.1 million was available for payment of dividends from Lakeland to the Company as of December 31, 2018.

The Company and Lakeland are subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory – and possible additional discretionary – actions by regulators that, if undertaken, could have a direct material effect on the Company’s and Lakeland’s consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company must meet specific capital guidelines that involve quantitative measures of the Company’s and Lakeland’s assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. The Company’s and Lakeland’s capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings and other factors.

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Quantitative measures established by regulations to ensure capital adequacy require the Company and Lakeland to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets, and of Tier 1 capital to average assets. Management believes, as of December 31, 2018, that the Company and Lakeland met all capital adequacy requirements to which they are subject.

As of December 31, 2018, the most recent notification from the FDIC categorized Lakeland as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, Lakeland must maintain minimum total risk-based, Tier 1 risk-based, common equity Tier 1 capital and Tier 1 leverage ratios as set forth in the table below. There are no conditions or events since that notification that management believes have changed the institution's category.

As of December 31, 2018 and 2017, the Company and Lakeland have the following capital ratios based on the then current regulations:

	Actual		For Capital Adequacy Purposes with Capital Conservation Buffer		To Be Well Capitalized Under Prompt Corrective Action Provisions	
December 31, 2018	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(dollars in thousands)					
Total capital (to risk-weighted assets)						
Company	$637,377	13.71%	> $458,952	> 9.875%	N/A	N/A
Lakeland	605,560	13.06%	$457,912	9.875%	> $463,708	> 10.00%
Tier 1 capital (to risk-weighted assets)						
Company	$523,577	11.27%	> $366,000	> 7.875%	N/A	N/A
Lakeland	565,549	12.20%	$365,170	7.875%	> $370,967	> 8.00%
Common equity Tier 1 capital (to risk-weighted assets)						
Company	$493,577	10.62%	> $296,285	> 6.375%	N/A	N/A
Lakeland	565,549	12.20%	$295,614	6.375%	> $301,410	> 6.50%
Tier 1 capital (to average assets)						
Company	$523,577	9.39%	> $222,982	> 4.00%	N/A	N/A
Lakeland	565,549	10.17%	$222,539	4.00%	> $278,173	> 5.00%

	Actual		For Capital Adequacy Purposes with Capital Conservation Buffer		To Be Well Capitalized Under Prompt Corrective Action Provisions	
December 31, 2017	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(dollars in thousands)					
Total capital (to risk-weighted assets)						
Company	$589,047	13.40%	> $406,477	> 9.25%	N/A	N/A
Lakeland	563,910	12.86%	$405,552	9.25%	> $ 438,435	> 10.00%
Tier 1 capital (to risk-weighted assets)						
Company	$477,453	10.87%	> $318,590	> 7.25%	N/A	N/A
Lakeland	525,979	12.00%	$317,865	7.25%	> $ 350,748	> 8.00%
Common equity Tier 1 capital (to risk-weighted assets)						
Company	$447,453	10.18%	> $252,675	> 5.75%	N/A	N/A
Lakeland	525,979	12.00%	$252,100	5.75%	> $ 284,983	> 6.50%
Tier 1 capital (to average assets)						
Company	$477,453	9.12%	> $209,431	> 4.00%	N/A	N/A

Lakeland	525,979	10.06 %	$209,239	4.00 %	>	$ 261,548	> 5.00 %

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The final rules implementing the Basel Committee on Banking Supervisions capital guidelines for U.S. Banks became effective for the Company on January 1, 2015, with full compliance with all the final rule's requirements phased in over a multi-year schedule, to be fully phased in by January 1, 2019. The Basel Rules require a "capital conservation buffer." The implementation of the capital conservation buffer began on January 1, 2016 at the 0.625% level and increases by 0.625% every January 1 until it reached 2.5% on January 1, 2019.

NOTE 21 - GOODWILL AND OTHER INTANGIBLE ASSETS

The Company reported goodwill of $136.4 million at both December 31, 2018 and December 31, 2017.

Core deposit intangible was $1.8 million on December 31, 2018 compared to $2.4 million on December 31, 2017. The Company recorded $691,000, $1.5 million and $2.7 million in core deposit intangible for the Harmony, Pascack and Somerset Hills acquisitions, respectively. In 2018, it has amortized $594,000 in core deposit intangible. The estimated future amortization expense for each of the succeeding five years ended December 31 is as follows (in thousands):

For the Year Ended	
2019	$505
2020	415
2021	326
2022	236
2023	147

NOTE 22 - CONDENSED FINANCIAL INFORMATION - PARENT COMPANY ONLY

CONDENSED BALANCE SHEETS

	December 31,	
	2018	2017
	(in thousands)	
ASSETS		
Cash and due from banks	$23,285	$17,695
Equity securities	2,743	5,158
Investment securities, held to maturity	1,000	1,000
Investment in subsidiaries	695,571	659,180
Other assets	7,182	6,013
TOTAL ASSETS	$729,781	$689,046
LIABILITIES AND STOCKHOLDERS' EQUITY		
Other liabilities	$1,015	$1,022
Subordinated debentures	105,027	104,902
Total stockholders' equity	623,739	583,122
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$729,781	$689,046

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CONDENSED STATEMENTS OF INCOME

	Years Ended December 31,		
	2018	2017	2016
	(in thousands)		
INCOME			
Dividends from subsidiaries	$30,589	$26,665	$20,687
Other income	(125)	2,750	199
TOTAL INCOME	30,464	29,415	20,886
EXPENSE			
Interest on subordinated debentures	5,141	5,091	2,171
Noninterest expenses	506	377	442
TOTAL EXPENSE	5,647	5,468	2,613
Income before (benefit) provision for income taxes	24,817	23,947	18,273
Income taxes (benefit) provision	(1,130)	(2,018)	(845)
Income before equity in undistributed income of subsidiaries	25,947	25,965	19,118
Equity in undistributed income of subsidiaries	37,454	26,615	22,400
NET INCOME AVAILABLE TO COMMON SHAREHOLDERS	$63,401	$52,580	$41,518

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CONDENSED STATEMENTS OF CASH FLOWS

	Years Ended December 31,		
	2018	2017	2016
	(in thousands)		
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income	$63,401	$52,580	$41,518
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Gain on securities	—	(2,539)	—
Amortization of subordinated debt costs	125	118	30
Change in market value of equity securities	338	—	—
Excess tax benefits	318	587	—
Increase in other assets	(1,446)	(1,927)	(922)
(Decrease) increase in other liabilities	(6)	(17)	1,010
Equity in undistributed income of subsidiaries	(37,454)	(26,615)	(22,400)
NET CASH PROVIDED BY OPERATING ACTIVITIES	25,276	22,187	19,236
CASH FLOWS FROM INVESTING ACTIVITIES			
Net cash used in acquisition	—	—	(5,356)
Purchases of available for sale securities	—	(79)	(62)
Purchases of equity securities	(78)	—	—
Proceeds from sale of available for sale securities	—	3,217	—
Proceeds from sale of equity securities	2,155	—	—
Contribution to subsidiary	—	—	(124,373)
NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES	2,077	3,138	(129,791)
CASH FLOWS FROM FINANCING ACTIVITIES			
Cash dividends paid on common stock	(21,307)	(18,853)	(16,007)
Proceeds from issuance of common stock, net	—	—	48,678
Proceeds from issuance of subordinated debt, net	—	—	73,516
Retirement of restricted stock	(763)	(773)	(206)
Excess tax benefits	—	—	43
Exercise of stock options	307	321	285
NET CASH (USED IN) PROVIDED BY FINANCING ACTIVITIES	(21,763)	(19,305)	106,309
Net increase (decrease) in cash and cash equivalents	5,590	6,020	(4,246)
Cash and cash equivalents, beginning of year	17,695	11,675	15,921
CASH AND CASH EQUIVALENTS, END OF YEAR	$23,285	$17,695	$11,675

ITEM 9 – Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.

Not Applicable

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ITEM 9A – Controls and Procedures.

Disclosure Controls

As of the end of the period covered by this Annual Report on Form 10-K, the Company's management, including the Chief Executive Officer and Chief Financial Officer, carried out an evaluation of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) pursuant to Securities Exchange Act Rule 15d-15(b).

Based on their evaluation as of December 31, 2018, the Company's Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) are effective in ensuring that the information required to be disclosed by the Company in the reports that the Company files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms and are operating in an effective manner and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Management's Report on Internal Control Over Financial Reporting

The management of Lakeland Bancorp, Inc. and its subsidiaries (the "Company") is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934.

The Company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

- Pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company;
- Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and the board of directors of the Company; and
- Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to risk that controls may become inadequate because of changes in conditions or because of declines in the degree of compliance with policies or procedures.

The Company's management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2018. In making this assessment, the Company's management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in Internal Control-Integrated Framework (2013).

As of December 31, 2018, based on management's assessment, the Company's internal control over financial reporting was effective.

Our independent registered public accounting firm, KPMG LLP, audited our internal control over financial reporting as of December 31, 2018. Their report, dated March 1, 2019, expressed an unqualified opinion on our internal control over financial reporting.

Changes in Internal Controls Over Financial Reporting

There have been no changes in the Company's internal control over financial reporting that occurred during the quarter ended December 31, 2018 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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Report of Independent Registered Public Accounting Firm
To the Stockholders and Board of Directors
Lakeland Bancorp, Inc.:

Opinion on Internal Control Over Financial Reporting

We have audited Lakeland Bancorp, Inc. and subsidiaries' (the Company) internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission. In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated balance sheets of the Company as of December 31, 2018 and 2017, the related consolidated statements of income, comprehensive income, changes in stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2018, and the related notes (collectively, the consolidated financial statements), and our report dated March 1, 2019 expressed an unqualified opinion on those consolidated financial statements.

Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ KPMG LLP

Short Hills, New Jersey
March 1, 2019

ITEM 9B – Other Information.
None.
PART III

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ITEM 10 – Directors, Executive Officers and Corporate Governance.

The Company responds to this Item by incorporating by reference the material responsive to this Item in the Company's definitive proxy statement for its 2019 Annual Meeting of Shareholders.

ITEM 11 - Executive Compensation.

The Company responds to this Item by incorporating by reference the material responsive to this Item in the Company's definitive proxy statement for its 2019 Annual Meeting of Shareholders.

ITEM 12 - Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

The Company responds to this Item by incorporating by reference the material responsive to this Item in the Company's definitive proxy statement for its 2019 Annual Meeting of Shareholders.

EQUITY COMPENSATION PLAN INFORMATION

The following table gives information about the Company's common stock that may be issued upon the exercise of options under the Company's 2018 Omnibus Equity Incentive Plan and the 2009 Equity Compensation Program as of December 31, 2018. These plans were the Company's only equity compensation plans in existence as of December 31, 2018. The 2018 Omnibus Equity Incentive Plan is the successor to the 2009 Equity Compensation Program and no additional awards will be granted under the 2009 Equity Compensation Program.

Plan Category	(a) Number Of Securities To Be Issued Upon Exercise Of Outstanding Options, Warrants and Rights	(b) Weighted-Average Exercise Price Of Outstanding Options, Warrants and Rights	(c) Number Of Securities Remaining Available For Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected In Column (a))
Equity Compensation Plans Approved by Shareholders	366,240	$ 8.59	1,991,870
Equity Compensation Plans Not Approved by Shareholders	—	—	—
TOTAL	366,240	$ 8.59	1,991,870

The number in column (a) does not include a total of 12,296 shares of Lakeland common stock that are issuable upon the exercise of options assumed in the Somerset Hills merger with a weighted average exercise price of $6.88.

ITEM 13 - Certain Relationships and Related Transactions, and Director Independence.

The Company responds to this Item by incorporating by reference the material responsive to this Item in the Company's definitive proxy statement for its 2019 Annual Meeting of Shareholders.

ITEM 14 - Principal Accounting Fees and Services.

The Company responds to this Item by incorporating by reference the material responsive to this Item in the Company's definitive proxy statement for its 2019 Annual Meeting of Shareholders.

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PART IV

ITEM 15 - Exhibits and Financial Statement Schedules.

(a) 1. The following portions of the Company's consolidated financial statements are set forth in Item 8 of this Annual Report:

(i) Consolidated Balance Sheets as of December 31, 2018 and 2017.
(ii) Consolidated Statements of Operations for each of the three years in the period ended December 31, 2018.
(iii) Consolidated Statements of Changes in Stockholders' Equity for each of the three years in the period ended December 31, 2018.
(iv) Consolidated Statements of Cash Flows for each of the three years in the period ended December 31, 2018.
(v) Notes to Consolidated Financial Statements.
(vi) Report of Independent Registered Public Accounting Firm.

(a) 2. Financial Statement Schedules

All financial statement schedules are omitted as the information, if applicable, is presented in the consolidated financial statements or notes thereto.

(a) 3. Exhibits

2.1	Agreement and Plan of Merger, dated as of August 23, 2018, by and between Lakeland Bancorp, Inc. and Highlands Bancorp, Inc., is incorporated by reference to Exhibit 2.1 to Registrant's Current Report on Form 8-K filed with the SEC on August 24, 2018.
3.1	Registrant's Restated Certificate of Incorporation, dated July 24, 2018, is incorporated by reference to Exhibit 3.1 to Registrant's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2018.
3.2	Registrant's Amended and Restated Bylaws are incorporated by reference to Exhibit 3.3 to Registrant's Annual Report on Form 10-K for the year ended December 31, 2012.
4.1	Indenture, dated as of September 30, 2016, between Lakeland Bancorp, Inc. and U.S. Bank National Association, as Trustee, is incorporated by reference to Exhibit 4.1 to the Registrant's Current Report on Form 8-K filed with the SEC on September 30, 2016
4.2	First Supplemental Indenture, dated as of September 30, 2016, between Lakeland Bancorp, Inc. and U.S. Bank National Association, as Trustee, is incorporated by reference to Exhibit 4.2 to the Registrant's Current Report on Form 8-K filed with the SEC on September 30, 2016.
10.1+	Lakeland Bancorp, Inc. 2018 Omnibus Equity Incentive Plan is incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed with the SEC on May 11, 2018.
10.2+	Lakeland Bancorp, Inc. 2009 Equity Compensation Program, as amended and restated effective February 27, 2014, is incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed with the SEC on February 28, 2014.
10.3+	Employment Agreement, dated as of April 2, 2008 and executed on May 22, 2008, among Lakeland Bancorp, Inc., Lakeland Bank and Thomas J. Shara, is incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed with the SEC on May 28, 2008.

10.4+	Supplemental Executive Retirement Plan Agreement for Thomas J. Shara, effective as of April 2, 2008, among Lakeland Bancorp, Inc., Lakeland Bank and Thomas J. Shara is incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed with the SEC on May 28, 2008.
10.5+	Lakeland Bancorp, Inc. Directors' Deferred Compensation Plan, as amended and restated, is incorporated by reference to Exhibit 10.6 to the Registrant's Current Report on Form 8-K filed with the SEC on December 30, 2008.
10.6+	Change in Control Agreement, dated as of June 12, 2009, among Lakeland Bancorp, Inc., Lakeland Bank and Ronald E. Schwarz, is incorporated by reference to Exhibit 10.25 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2010.
10.7+	Somerset Hills Bancorp 2001 Combined Stock Option Plan is incorporated by reference to Exhibit 4.6 to the Registrant's Registration Statement on Form S-8 filed with the SEC on June 3, 2013.
10.8+	Somerset Hills Bancorp 2007 Equity Incentive Plan is incorporated by reference to Exhibit 4.7 to the Registrant's Registration Statement on Form S-8 filed with the SEC on June 3, 2013.

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10.9+	Somerset Hills Bancorp 2012 Equity Incentive Plan is incorporated by reference to Exhibit 4.8 to the Registrant's Registration Statement on Form S-8 filed with the SEC on June 3, 2013.
10.10+	Change of Control Agreement, dated October 31, 2013, among Lakeland Bancorp, Inc., Lakeland Bank and Timothy J. Matteson, is incorporated by reference to Exhibit 10.2 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2013.
10.11+	Amendment, dated November 6, 2014, to Change in Control Agreement, dated October 31, 2013, among Lakeland Bancorp, Inc., Lakeland Bank and Timothy J. Matteson, as incorporated by reference to Exhibit 10.1 to the Registrants' Quarterly Report on Form 10-Q for the quarter ended September 30, 2014.
10.12+	Deferred Compensation Agreement, dated February 27, 2015, among Lakeland Bancorp, Inc., Lakeland Bank and Thomas J. Shara, is incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed with the SEC on March 2, 2015.
10.13+	Lakeland Bancorp, Inc. Elective Deferral Plan is incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed with the SEC on March 20, 2015.
10.14+	Amendment, dated August 7, 2015, to Employment Agreement, dated April 2, 2008 and executed May 22, 2008, among Lakeland Bancorp, Inc., Lakeland Bank and Thomas J. Shara, is incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed with the SEC on August 7, 2015.
10.15+	Amendment, dated August 7, 2015, to Change in Control Agreement, dated June 12, 2009, among Lakeland Bancorp, Inc., Lakeland Bank and Ronald E. Schwarz, is incorporated by reference to Exhibit 10.4 to the Registrant's Current Report on Form 8-K filed with the SEC on August 7, 2015.
10.16+	Amendment, dated August 7, 2015, to Change in Control Agreement, dated October 31, 2013, as amended, among Lakeland Bancorp, Inc., Lakeland Bank and Timothy J. Matteson, is incorporated by reference to Exhibit 10.8 to the Registrant's Quarterly Report on Form 10-Q for the period ended June 30, 2015.
10.17+	Change in Control Agreement, dated as of April 11, 2016, among Lakeland Bancorp, Inc., Lakeland Bank and James Nigro, is incorporated by reference to Exhibit 10.1 to the Registrant's Quarterly Report on Form 10-Q filed with the SEC on May 10, 2016.
10.18+	Change in Control Agreement, dated as of March 15, 2017, among Lakeland Bancorp, Inc., Lakeland Bank and Thomas Splaine, is incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed with the SEC on March 16, 2017.
10.19	Master Agreement, dated October 31, 2017 among Lakeland Bancorp, Inc., Lakeland Bank and Fiserv Solutions, LLC, is incorporated by reference to Exhibit 10.29 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2017. (Portions of this Exhibit have been omitted pursuant to a request for confidential treatment.)
10.20+	Amended Change in Control Agreement, dated January 1, 2018, among Lakeland Bancorp, Inc., Lakeland Bank and Ellen Lalwani, is incorporated by reference to Exhibit 10.30 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2017.
10.21+	

	Change in Control Agreement, dated January 1, 2018, among Lakeland Bancorp, Inc., Lakeland Bank and John Rath, is incorporated by reference to Exhibit 10.31 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2017.
12.1	Statement of Ratios of Earnings to Fixed Charges.
21.1	Subsidiaries of Registrant.
23.1	Consent of KPMG LLP.
24.1	Power of Attorney.
31.1	Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Principal Executive Officer and Principal Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

101.INS XBRL Instance Document

101.SCH XBRL Taxonomy Extension Schema Document

101.CAL XBRL Taxonomy Extension Calculation Linkbase Document

101.DEF XBRL Taxonomy Extension Definition Linkbase Document

101.LAB XBRL Taxonomy Extension Label Linkbase Document

101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

+ Denotes management contract or compensatory plan, contract or arrangement.

ITEM 16 – Form 10-K Summary.

Not applicable.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

LAKELAND BANCORP, INC.

Dated: March 1, 2019	By:	/s/ Thomas J. Shara Thomas J. Shara President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Capacity	Date
/s/ Bruce D. Bohuny* Bruce D. Bohuny	Director	March 1, 2019
/s/ Mary Ann Deacon* Mary Ann Deacon	Chairman	March 1, 2019
/s/ Brian M. Flynn* Brian M. Flynn	Director	March 1, 2019
/s/ Mark J. Fredericks* Mark J. Fredericks	Director	March 1, 2019
/s/ James E. Hanson II * James E. Hanson II	Director	March 1, 2019
/s/ Janeth C. Hendershot* Janeth C. Hendershot	Director	March 1, 2019
/s/ Lawrence R. Inserra, Jr.* Lawrence R. Inserra, Jr.	Director	March 1, 2019
/s/ Thomas J. Marino* Thomas J. Marino	Director	March 1, 2019
/s/ Robert E. McCracken* Robert E. McCracken	Director	March 1, 2019
/s/ Robert B. Nicholson, III* Robert B. Nicholson, III	Director	March 1, 2019

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Signature	Capacity	Date
/s/ Thomas J. Shara Thomas J. Shara	Director, President and Chief Executive Officer (Principal Executive Officer)	March 1, 2019
/s/ Thomas Splaine Thomas Splaine	Executive Vice President and Chief Financial Officer (Principal Financial Officer and Principal Accounting Officer)	March 1, 2019

*By: /s/ Thomas J. Shara   March 1, 2019
Thomas J. Shara
Attorney-in-Fact